

**REPORT OF  
ASSOCIATION EXAMINATION  
OF  
THE MEDICAL ASSURANCE COMPANY, INC.  
BIRMINGHAM, ALABAMA**

**AS OF  
DECEMBER 31, 2002**

**PARTICIPATION:  
SOUTHEASTERN ZONE  
ALABAMA  
MIDWESTERN ZONE  
MISSOURI**

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EXAMINER'S AFFIDAVIT

STATE OF ALABAMA  
COUNTY OF Jefferson

Mary B. Packard, being first duly sworn, upon her oath

deposes and says:

That she is an examiner appointed by the Commissioner of Insurance for the State of Alabama;

That an examination was made of the affairs and financial condition of The Medical Assurance Company, Inc., for the period of January 1, 1998 through December 31, 2002.

That the following 43 pages constitute the report thereon to the Commissioner of Insurance of the State of Alabama.

And that the statements, exhibits, and data therein contained are true and correct to the best of her knowledge and belief.

Mary B. Packard  
Examiner-in-charge

Subscribed and sworn to before the undersigned authority this 22<sup>nd</sup> day of August 2003

Tonia King  
(Signature of Notary Public)

TONIA KING Notary Public  
(Print Name)

in and for the State of Alabama.

My Commission expires 6-20-04



BOB RILEY  
GOVERNOR

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JOHN S. ROBISON  
GENERAL COUNSEL  
MICHAEL A. BOWNES  
RECEIVER  
DENISE B. AZAR  
PRODUCER LICENSING MANAGER  
JIMMY W. GUNN

August 22, 2003  
Birmingham, Alabama

Honorable José Montemajor, Commissioner, Chairman, Examination Oversight Committee  
Texas Insurance Department  
333 Guadalupe  
Austin, Texas 78701

Honorable Alfred W. Gross, Commissioner, Secretary, Southeastern Zone  
State Corporation Commission  
Bureau of Insurance  
Commonwealth of Virginia  
Post Office Box 1157  
Richmond, Virginia 23218

Honorable Sally McCarty, Commissioner, Secretary, Midwestern Zone  
Indiana Department of Insurance  
311 West Washington Street, Suite 300  
Indianapolis, Indiana 46204-2787

Honorable Walter A. Bell, Commissioner  
Alabama Department of Insurance  
Post Office Box 303350  
Montgomery, Alabama 36130-3350

Dear Commissioners:

Pursuant to your authorizations and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners (NAIC), an examination has been made of the affairs and financial condition of

**THE MEDICAL ASSURANCE COMPANY, INC.**  
**Birmingham, Alabama**

at its Home Office located at 100 Brookwood Place, Birmingham, Alabama 35209, as of December 31, 2002. The report of examination is submitted herewith. Where the description "Company" appears herein without qualification, it will be understood to indicate The Medical Assurance Company, Inc.

## SCOPE OF EXAMINATION

The Company was last examined for the five-year period ended December 31, 1997 by examiners from Alabama, representing the Southeastern Zone, NAIC. The current examination covers the intervening period from the date of the last examination through December 31, 2002 and was conducted by examiners from Alabama, representing the Southeastern Zone, NAIC and from Missouri, representing the Midwestern Zone, NAIC. The examination was conducted concurrently with the examination of an affiliate, Red Mountain Casualty Insurance Company, Inc. (RMC), Birmingham, Alabama. Where deemed appropriate, transactions subsequent to 2002 were reviewed.

The examination was made in accordance with the statutory requirements of the Alabama Insurance Code and the Alabama Insurance Department's regulations and bulletins; in accordance with the applicable guidelines and procedures promulgated by the NAIC; and in accordance with generally accepted examination standards and practices in connection with the verification of assets and determination of liabilities.

The examination included an inspection of corporate records, test checks of recorded income and disbursement items for selected periods, and a general review of records and files pertaining to operations, administrative practices and compliance with statutes and regulations. Assets were verified and valued and all known liabilities were established or estimated as of December 31, 2002, as shown in the Financial Statements contained herein. However, the discussion of assets and liabilities contained in this report is confined to those items where a change was made by the examiners, or which indicated violation of the Alabama Insurance Code and the Insurance Department's rules and regulations or other insurance laws or rules, or which was deemed to require comments or recommendations.

A Company office copy of the filed Annual Statement for the year 2002 was compared with or reconciled to account balances with respect to ledger items.

The market conduct review consisted of a review of the Company's plan of operation, territory, policy forms and underwriting practices, dividends to policyholders, advertising, claims payments, policyholder complaints and compliance with agents' licensing requirements.

The Company's accounts were examined by Ernst & Young, LLP, certified public accountants (CPAs), for each of the five years under examination. Audit reports, management letters, and audit workpapers were made available to the examiners and were used where deemed appropriate in the completion of this examination. The Company does not maintain an internal audit department; however, its ultimate parent, ProAssurance Corporation, does maintain an internal audit department, which services the parent and its subsidiaries.

A signed certificate of representation was obtained during the course of the examination. In this certificate, management attests to having valid title to all assets and to the nonexistence of material unrecorded liabilities as of December 31, 2002.

## ORGANIZATION AND HISTORY

The Company was incorporated as a mutual insurance company under the laws of the State of Alabama on October 1, 1976, and commenced business on April 15, 1977. The Company was organized under the auspices of the Medical Association of the State of Alabama, hereinafter referred to as the "Association."

The restated Articles of Incorporation provided that the primary purpose of the Company shall be to provide for the professional liability insurance needs of Alabama physicians. The articles further provided that the Company could pursue other valid corporate purposes as long as those purposes did not thwart or preclude the advancement of the Company's primary purpose. The other purposes included the writing of other lines of property and casualty insurance or lines of insurance as the Company may from time to time be legally authorized to write. Other usual and customary purposes for a property and casualty insurance company were included in the Company's authority to do business.

At a special members' meeting held on January 20, 1987, the Company amended its Certificate of Incorporation to change its name from "Mutual Assurance Society of Alabama" to "Mutual Assurance, Inc."

In 1989, the Board of Directors of the Company authorized the development of a plan to convert the Company from a mutual insurer to a stock insurer. The three primary reasons for the conversion to a stock company were:

- (1) As a stock company, the Company would enjoy greater access to the capital markets. Any increase in capital would help reduce the Company's reliance on the reinsurance markets and enhance its operational and financial independence;
- (2) by converting into a stock company, the Company could provide its members, who have contributed to the surplus of the company but who would otherwise forfeit all interests in the company upon their death or retirement, value for their interests in the company in the form of either stock or cash; and
- (3) conversion would provide the Company additional methods of attracting, retaining, and compensating qualified management in the form of incentive compensation or otherwise.

In December 1989, the Board adopted a Plan of Conversion, which was filed with the Alabama Commissioner of Insurance on December 29, 1989. An amended and restated Plan of Conversion was adopted by the Board and filed with the Alabama Commissioner of Insurance on May 23, 1990. The amended and restated plan was approved by the Alabama Commissioner of Insurance on June 25, 1990, after a public hearing thereon. The members of the Company approved the Plan of Conversion on March 15, 1991. The amended and restated Plan of Conversion provided for the conversion of the Company to a stock insurer through the issuance of shares of stock to certain current and former policyholders of the Company in exchange for their share of the equity in the Company.

On September 11, 1991, the Company converted from a mutual insurance company controlled by its policyholders to a stock company controlled by its stockholders. The Articles of Incorporation were restated and amended on May 11, 1994, "to state more specifically the purposes for which the Corporation is organized." The last amendment to the By-Laws was August 27, 1992, whereby ARTICLE II, Section 12 and ARTICLE III, Section 14 were added to that document.

In 1993, the Company started the process of repurchasing its stock on the open market. During that year, the Company purchased treasury stock for \$3,885,619. On the 1994 Annual Statement, the Company listed treasury stock as \$3,846,669, less than in 1993, but the amount increased in 1995 to \$7,230,931.

On January 1, 1994, the Company purchased all the outstanding stock of West Virginia Hospital Insurance Company, which was the start of the Company's expansion of its business into other states. This was in an effort to increase the volume of its professional liability insurance business.

Effective January 1, 1995, the Company purchased 51.7 percent of the outstanding capital voting stock of Physicians Insurance Company of Indiana (PIC-Ind.). On May 1, 1995, the Company purchased additional shares of PIC-Ind. stock for a total of 99 percent of the outstanding capital voting stock.

Effective July 16, 1995, the Company acquired the recurring medical professional insurance book of business of Physicians Insurance Company of Ohio (PIC-Ohio) and its subsidiary, the Professionals Insurance Company (PIC).

The Company formed a Delaware corporation, MAIC Holdings, Inc., (MAIC) to serve as a holding corporation for the Company and other subsidiaries. On August 31, 1995, the two companies consummated an Agreement and Plan of Exchange, which generally provided that each share of common stock of the Company, par value \$1 per share, would be exchanged for one share of common stock of MAIC, par value \$1 per share. MAIC's common stock succeeded the Company's common stock for trading on the NASDAQ/NMS under the trading symbol "MAIC."

On October 5, 1999, the Company changed its name from Mutual Assurance, Inc. to The Medical Assurance Company, Inc. At the May 18, 2000 Board meeting, the directors voted to liquidate and dissolve PROActive Insurance Corporation and its parent, MAI Corporation, a Delaware corporation, a wholly owned subsidiary of the Company, upon the transfer of the PROActive stock to the Company.

On September 18, 2000, the Company and Medical Assurance of Indiana merged with the Company being the surviving corporation. On October 18, 2000, the Company merged with Medical Assurance of Missouri, and the Company was the surviving corporation.

On June 22, 2000, Medical Assurance, Inc. (MAI), the Company's parent, entered into an Agreement to Consolidate with Professionals Group, Inc. (PGI), which provided for the formation of ProAssurance Corporation (ProAssurance), a new holding company of MAI and PGI. On June 27, 2001, MAI's shares were exchanged for those of ProAssurance as provided in the agreement. PGI's shares were acquired in part through the issuance of ProAssurance stock and in part through the payment of cash. The Company paid its parent a \$45,000,000 dividend, which was used to purchase PGI's shares.

The Company's authorized capital at December 31, 2002, consisted of 12,000,000 shares of \$1 par value per share common stock for total authorized capital of \$12,000,000. At December 31, 1997, there were 8,972,237 shares issued and outstanding, which had not changed as of December 31, 2002.



At December 31, 2002, paid in and contributed surplus was \$165,427,959. The following chart is a reconciliation of this account for the period covered by this examination:

<b>Beginning paid in and contributed surplus, December 31, 1997</b>	<b>\$88,686,492</b>
2000 – mergers of the Indiana & Missouri companies	40,741,467
2002 – capital contribution from parent	36,000,000
<b>December 31, 2002 paid in and contributed surplus</b>	<b>\$165,427,959</b>

Other facts concerning details of the Company's organization and history are contained in reports of previous examinations on file with the Alabama Department of Insurance.

## **MANAGEMENT AND CONTROL**

### **Stockholder**

The Company is a stock corporation with ultimate control vested in its stockholder. The Company is a wholly owned subsidiary of Medical Assurance, Inc., a Delaware stock corporation. Medical Assurance, Inc. is 100 percent owned by ProAssurance Corporation, a Delaware stock corporation and the ultimate parent company.

### **Board of Directors**

Members elected to the Board of Directors by the sole shareholder of the Company, Medical Assurance, Inc., in accordance with the By-Laws of the Company and serving at December 31, 2002, were as follows:

<b><u>Director/Address</u></b>	<b><u>Title</u></b>
Aubrey Derrill Crowe Birmingham, Alabama	Chairman & Chief Executive Officer ProAssurance Corporation
Victor Thomas Adamo Birmingham, Alabama	President & Chief Operating Officer ProAssurance Corporation
Paul Richard Butrus Birmingham, Alabama	Vice Chairman ProAssurance Corporation
Howard Harley Friedman Birmingham, Alabama	Chief Financial Officer ProAssurance Corporation

### **Committees**

There were no active committees for the Company in place at December 31, 2002.

## **Officers**

The following officers were elected by the Board of Directors and were serving at December 31, 2002:

<b><u>Officer</u></b>	<b><u>Title</u></b>
Aubrey Derrill Crowe	Chairman of the Board, President
Victor Thomas Adamo	Vice Chairman
Paul Richard Butrus	Vice Chairman
James Joseph Morello	Senior Vice President, Treasurer
Kathryn Anne Neville	Vice President, Secretary
Howard Harley Friedman	Senior Vice President, Assistant Treasurer, Assistant Secretary
John Ogden Bashant	Senior Vice President
Jeffrey Lynn Bowlby	Senior Vice President
Robert David Francis	Senior Vice President
Frank Berry O'Neil	Senior Vice President
William Paul Sabados	Senior Vice President
Darryl Keith Thomas	Senior Vice President

## **Management and Service Agreements**

The Company had two employment agreements and a release and severance compensation agreement with three employees and a service agreement with the Medical Association of the State of Alabama.

### **1) Employment Agreements**

**A)** An employment agreement with Aubrey Derrill Crowe, M.D. has been in effect since January 1, 1982, and was amended in 1988. The amendment provided for a three-year term of employment that would be automatically renewed for additional three-year terms unless either party gives thirty days notice not to renew the contract. The Company may terminate the agreement for "good cause," which was defined within the agreement, without being liable for the three-year annual compensation of Dr. Crowe. In the event of termination for other than "good cause," the Company must fulfill its obligations to pay Dr. Crowe for the remaining term of the contract as liquidated damages.

**B)** An employment agreement with an executive (Executive) was effective from June 3, 2002 through and including June 3, 2004. The Company may terminate the agreement for "Cause" as defined within the agreement. In the event of termination for any reason, the Executive shall be entitled to monies, payments and benefits as defined in the agreement. In the event the Company terminates the Executive without cause, the Company shall pay the Executive what is due him or her plus an additional amount to be calculated as outlined in the agreement. However, as the agreement expires in less than a year, the Company does not expect any payouts discussed in this agreement to be triggered. In addition, the agreement contained a non-competition section in which the Executive agrees to certain conditions laid out in the agreement during a restricted period as defined within the agreement.

## **2) Release and Severance Compensation Agreement**

The Release and Severance Compensation Agreement was between ProAssurance Corporation, Medical Assurance, Inc., the Company (collectively referred to as "Companies") and an executive (Executive). The Executive was under an Employment Agreement that was effective January 1, 1999, and the Companies wanted to terminate the Agreement effective December 31, 2001. Thereafter, the Companies would employ the Executive in an at will employment relationship subject to the obligation of the Companies to pay severance benefits on termination of Executive's employment under certain circumstances on the condition that the Executive releases the Companies from any past or future liability under the Employment Agreement. The agreement was effective on January 1, 2002 until December 31, 2002 and thereafter, the agreement automatically extended for successive one-year terms. In addition, the agreement contained a non-competition section in which the Executive agrees to certain conditions laid out in the agreement.

## **3) Service Agreement**

The service agreement between the Company and the Medical Association of the State of Alabama (MASA) was effective for five years from January 1, 1999 through December 31, 2003 and thereafter for successive five-year periods until terminated. The agreement stated that MASA would provide the Company with services including continuing medical education programs for the Company's insureds, advertising to MASA members the Company's products, and representing the interests of the Company before the Legislative and Executive branches of State and Federal governments and the Regulatory Agencies thereof. In exchange for these services, the Company paid MASA annually, acted as administrator of the Blue Cross Blue Shield Health Insurance program sponsored by MASA at no further or additional cost, and financially supported other activities of MASA designed to encourage membership and participation in all aspects of organized medicine. It was noted that the Company had not been administering the Blue Cross Blue Shield Health Insurance program for MASA for the past five years.

## **Conflicts of Interest**

The Company adopted a Statement of Policy on Conflicts of Interest, which was approved by the Board of Directors at a meeting held September 28, 1978, which required that Conflict of Interest Statements be signed every year by directors, officers and other employees.

The Conflict of Interest Statements filed for the five-year period covered by this examination were reviewed. In 1998, a Director of the Company did not sign a Statement. In 2001, the Statements were not signed by any officer, director or other employee due to the June 2001 merger between Medical Assurance, Inc. and Professionals Group, Inc. In all other years under examination, the Statements were signed as required.

## **CORPORATE RECORDS**

The Articles of Incorporation and By-Laws, as amended, were inspected during the course of the examination and appeared to provide for the operation of the Company in accordance with usual corporate practice and applicable statutes and regulations.

Minutes of meetings of the stockholder and Board of Directors were reviewed for the period under examination. The minutes appeared to be complete with regard to recording actions taken on matters before the respective bodies for deliberation and action.

## **HOLDING COMPANY AND AFFILIATE MATTERS**

### **Holding Company**

The Company is subject to the Alabama Insurance Holding Company Regulatory Act as defined in ALA. CODE §27-29-1 (1975). In connection therewith, the Company is registered with the Alabama Department of Insurance as joint registrant of an Insurance Holding Company System. Appropriate filings required under the Holding Company Act were made from time to time by the Company as joint registrant. A review of the Company's filings during the period under review did not disclose any omissions in them.

### **Dividends to Stockholders**

The Company paid the following dividends during the period covered by this examination:

<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
\$15,000,000	\$20,000,000	\$50,000,000	\$45,000,000	-0-

The only extraordinary dividend paid was in 2001. The Company requested a distribution to the parent company as part of a Plan of Exchange, which was approved by the Alabama Department of Insurance on May 29, 2001.

### **Management and Service Agreements**

#### **1) Management Agreement**

This agreement is between MAIC Holdings, Inc., (MAIC), a Delaware corporation, which subsequently changed its name to Medical Assurance, Inc., and Mutual Assurance, Inc., an Alabama stock insurer, which subsequently changed its name to The Medical Assurance Company, Inc. (Company). A Form D was filed on January 3, 1997, with the Alabama Department of Insurance.

The parties agree that:

1. Engagement and Term - MAIC is to perform certain services on the terms and conditions commencing January 1, 1997, and continuing for successive one-year periods. A thirty day written notice is required for termination.
2. Duties of MAIC - The duties to be performed by MAIC were Accounting Services, Data Processing Services, Administrative Services, and Clerical Support.
3. Compensation – The Company shall pay MAIC an amount equal to the cost incurred by MAIC in the employment of the personnel required to perform the duties undertaken by MAIC pursuant to this Agreement. Invoices shall be submitted for services.

4. Authority of MAIC - MAIC shall have full power and authority to determine the identity and number of persons who are necessary to perform the services required hereunder and such persons shall be employees of MAIC.
5. Duties of the Company - The Company shall, at its expense, provide to MAIC such office space, equipment and services as may be reasonably required by MAIC to perform its duties.
6. Liability and Indemnification - Except in the case of gross negligence or willful misconduct, MAIC shall not be liable, responsible or accountable in damages or otherwise to the Company for any act or the failure to act, which may cause or result in loss or damage to the Company.
7. Independent Contractor - This agreement shall be construed as a relationship between the parties as principal and independent contractor.
8. Assignment - Rights and obligations under this agreement shall be not assigned without written consent.
9. Entire Agreement - No alteration, modification or interpretation shall be binding unless in writing and signed by all of the parties.
10. Miscellaneous - This agreement shall be interpreted, construed and governed according to the laws of the State of Alabama.

## **2) Expense Allocation Agreement**

This agreement was entered into on January 1, 2002, between The Medical Assurance Company, Inc. (Company), ProNational Insurance Company (ProNational), Medical Assurance, Inc. (MAI), Professionals Group, Inc. (PGI) and ProAssurance Corporation (ProAssurance) and was approved by the Alabama Department of Insurance on April 9, 2002. These companies agree to the following:

1. Allocation of Direct Expenses will be allocated to the company incurring such expense.
2. Allocation of Indirect Expenses will be allocated during each accounting period on a closely estimated basis. For purposes of developing this estimate, indirect expenses will be allocated in a fair and reasonable method in conformity with customary insurance accounting practices and that method shall be consistently applied.
3. Expenses will be settled on a quarterly basis.
4. Terms of Agreement: Unless amended or modified, the agreement will continue in force for subsequent years beyond the original term of January 1, 2002, through December 31, 2002.
5. Amendments: Amendments to the agreement must be in writing and signed by authorized representatives from each party.
6. Severability: If any part of the agreement is held invalid, all other parts will remain in full force and effect.

## **3) Insurance Company - Management Services Agreement**

This agreement was entered into on January 1, 2002, between The Medical Assurance Company, Inc. (Company) and ProNational Insurance Company (ProNational). The agreement was approved by the Alabama Department of Insurance on April 9, 2002.

Management Services will be shared among parties of the agreement. The Company agreed to make available its resources, and ProNational agreed to grant the Company, as Manager, access to its resources. The following includes all services provided under the direction of the Company:

- Accounting Services, Financial Statements and Tax Returns

- Underwriting
- Reinsurance
- Sales and Service
- Claims Administration
- Information Systems
- Administrative and Other Services
- Risk Management

Delegation of Duties: The Company may perform the Management Services using the personnel of any of the parties to this agreement or engage consultants, advisors, investment managers and such other third-parties as may be reasonably required to perform the Management Services.

Direct and indirect expenses will be allocated in accordance with the expense allocation agreement. The Company shall not charge any management fee, commission, or override for performing the services of Manager as set forth in this agreement. Unless amended or modified, the agreement will continue in force for subsequent years beyond the original term of January 1, 2002 to December 31, 2002.

Management Services provided shall be subject to the review and approval of the Board of Directors. The Board shall approve, at least annually, the scope of service to be provided by the Company. At least annually, the Company, as the Manager, will report to each company the allocation of expenses as set forth in the agreement. Each company's Board of Directors shall review and approve the allocation. Amendments must be in writing and signed by authorized representatives of the parties of this agreement. If any part of this agreement shall be held invalid for any reason, such invalidity shall not affect any other part of this agreement, and the other parts of this agreement shall remain in full force and effect.

#### **4) ProAssurance Corporation and Subsidiaries Consolidated Tax Allocation Agreement**

This agreement is between ProAssurance Corporation (ProAssurance) and its subsidiaries (Members) and was entered into on June 27, 2001, and was approved by the Alabama Department of Insurance on December 20, 2002. This agreement succeeds the Consolidated Tax Allocation Agreement entered into on December 30, 2000, between Medical Assurance, Inc. and its subsidiaries and the Tax Allocation Agreement dated September 15, 2000, between Professionals Group, Inc. and its subsidiaries.

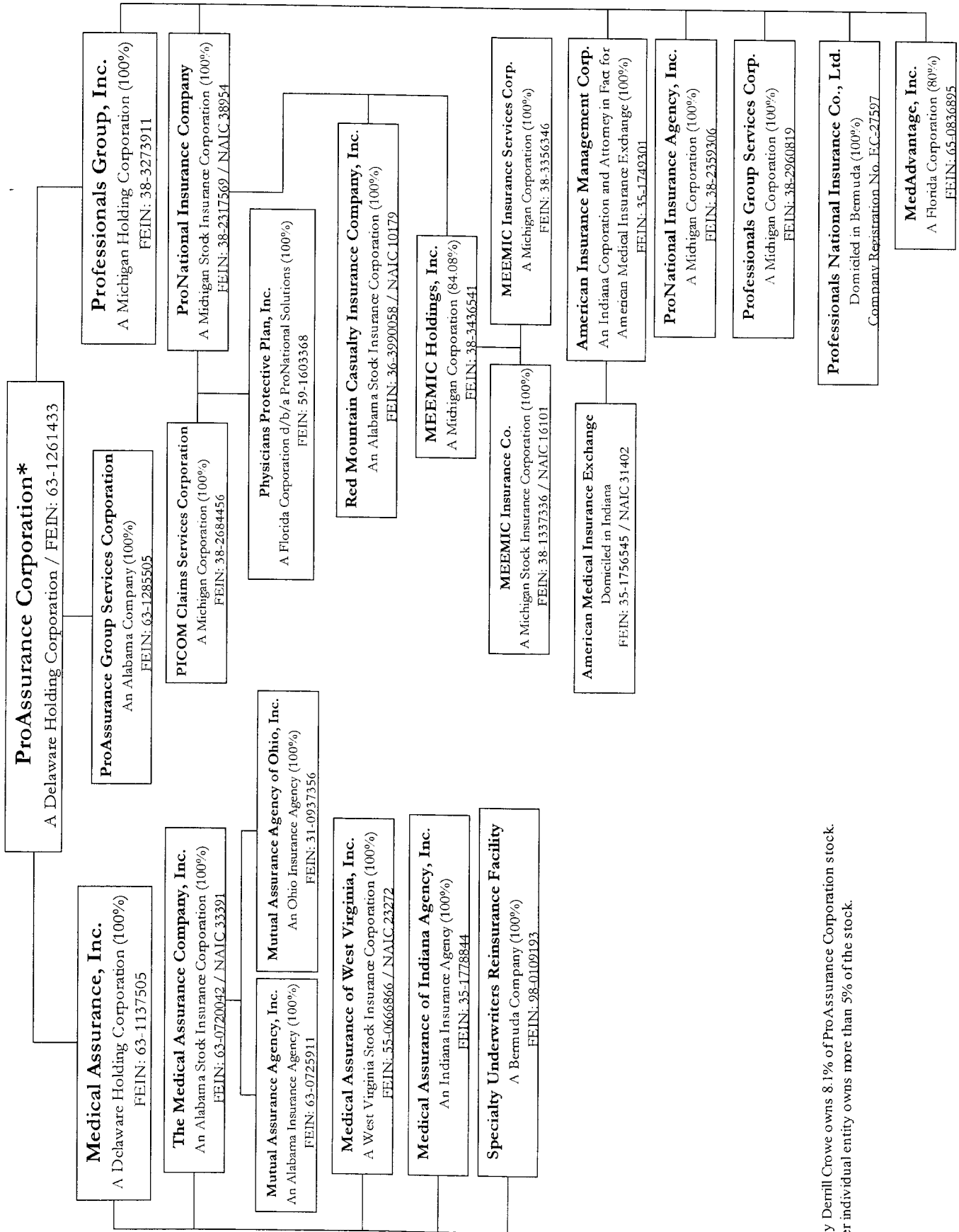
The members have agreed and elected to file a consolidated federal income tax return pursuant to the provisions of IRS Section 1501. The method of allocation is pursuant to Regulation Section 1.1552-1(c). Tax liability will be allocated among the Members according to the ratio of each member's taxable income to the consolidated taxable income. The calculation will be pursuant to Regulation Section 1.1552(a)(1). Amounts shall be paid on the applicable due date. Compensating payments will be made in accordance with Regulation Section 1.1502-33 (d)(2)(ii).

The terms are from the day of execution until termination by the mutual agreement of the Members. Termination is subject to approval by the IRS, in accordance with Regulations Sections 1.1502-33(d)(3) and 1.1552-1(c). Termination of the agreement to a certain company is automatic when any member ceases to be affiliated with ProAssurance. Amendments, modifications, and supplements

shall be mutually agreed upon by the Members. Invalidation, whether judicial or otherwise, of any article, term, condition or provision contained in this agreement shall in no way affect any other provisions of this agreement, all of which shall remain in full force and effect.

### **Organizational Chart**

- The following chart presents the identities of and interrelationships among all affiliated persons within the Insurance Holding Company System at December 31, 2002:



\* Aubrey Derrill Crowe owns 8.1% of ProAssurance Corporation stock.  
No other individual entity owns more than 5% of the stock.



## **FIDELITY BOND AND OTHER INSURANCE**

At December 31, 2002, the Company was named as an insured on a Financial Institutions Bond issued to ProAssurance Corporation, the Company's ultimate parent, by the Cincinnati Insurance Company. Coverage was provided in accordance with the NAIC suggested minimums.

During the period covered by this examination, the Company also maintained the following coverages:

- Commercial Package policy
- Commercial Inland Marine
- Employee Benefits Liability
- Directors and Officers Liability
- Workers' Compensation
- Employment Practices Liability
- Commercial Umbrella policy
- Commercial Automobile

## **EMPLOYEE AND AGENT WELFARE**

The Company provided the following benefits for its employees during the five-year examination period:

- Group Insurance
- Health/Dental Insurance
- Life Insurance
- Disability Insurance
- Workers' Compensation
- Pension Plan
- 401(k) Savings Plan
- Stock Purchase Plan
- Flexible Spending Accounts
- Paid Vacations and Holidays
- Sick Leave
- Short and Long-term Disability
- Personal Leave
- Leaves of Absence
- Education Assistance
- Job Counseling

It was noted during the examination that the Company did not determine if any prohibited persons, as defined by the Violent Crime Control & Law Enforcement Act of 1994, U.S. Code, Section 1033, were employed by the Company. The Company performed background checks on all directors,

were employed by the Company. The Company performed background checks on all directors, officers and agents but not on other employees. Per the Compliance staff, the Human Resources (HR) Department personnel began performing background checks on all new hires as of May 1, 2003. In addition, the Employee Handbook is being revised to include a section on the federal law. All employees will receive the revised handbook, and will be asked to sign a statement stating that they read and understood the handbook. Once the statements are signed, HR personnel will conduct background checks on all existing employees. The employment application is also being revised to include a section on the federal law and a place for applicants to fill in and sign.

### SCHEDULE OF SPECIAL DEPOSITS

The Company had on deposit the following amounts at December 31, 2002:

LOCATION	PAR VALUE	STATEMENT VALUE	MARKET VALUE
State of Alabama	\$ 2,600,000	\$ 2,613,850	\$ 2,772,769
State of Arkansas	250,000	271,286	276,875
State of Georgia	85,000	84,974	86,805
State of Idaho	250,000	249,812	262,890
State of Indiana	110,000	111,481	126,569
State of Louisiana	70,000	70,000	70,000
Commonwealth of Massachusetts	550,000	576,829	609,125
State of Minnesota	150,000	162,771	166,125
State of Mississippi	50,000	51,536	56,906
State of Missouri	1,000,000	1,001,677	1,013,130
State of Nevada	500,000	500,000	500,000
State of New Mexico	100,000	108,514	110,750
State of North Carolina	550,000	596,829	609,125
State of Tennessee	200,000	199,990	201,188
Commonwealth of Virginia	275,000	274,996	279,813
Trust Agreement with Frontier Corp.	2,871,100	2,871,100	2,871,100
Trust Agreement with Frontier Corp. SubAccount	1,210,344	1,210,344	1,210,344
Trust Agreement with Reliastar Life Insurance Company	428,756	428,756	428,756
Trust Agreement with Transatlantic Reinsurance	592,450	592,450	592,500
<b>TOTALS</b>	<b>\$11,842,650</b>	<b>\$11,997,195</b>	<b>\$12,244,769</b>

## FINANCIAL CONDITION/GROWTH OF THE COMPANY

The following table sets forth the significant items indicating the growth and financial condition of the Company for the period under review:

	1997*	1998	1999	2000**	2001	2002*
- Admitted assets	\$633,876,751	\$718,859,029	\$723,217,751	\$789,865,073	\$814,313,943	\$947,066,456
Liabilities	475,002,141	525,169,320	511,643,244	581,059,963	641,473,247	766,243,156
Common capital stock	8,972,237	8,972,237	8,972,237	8,972,237	8,972,237	8,972,237
Gross paid in and contributed capital	88,686,492	88,686,492	88,686,492	129,427,959	129,427,959	165,427,959
Unassigned funds (surplus)	61,215,881	96,030,980	113,915,778	70,404,916	34,440,500	6,423,104
Premiums earned	110,989,166	140,025,571	164,116,311	187,591,444	183,746,186	185,456,783
Losses incurred	22,220,128	23,555,920	24,874,661	40,726,452	84,393,685	85,125,978

\*Per Examination

\*\*Amounts were taken from the filed Annual Statement. The Admitted Assets and Liabilities were restated in the 2001 Annual Statement due to the two mergers in 2000.

## MARKET CONDUCT ACTIVITIES

### Plan of Operation

The Company was a property and casualty insurer, offering professional liability insurance and related liability for physicians, surgeons, dentists, hospitals, and others engaged in the delivery of health care in Alabama and other regional states. At December 31, 2002, the Company insured approximately 4,600 physicians in Alabama, 4,000 in Indiana, 3,500 in Ohio, and 2,200 in other states. The Company insured approximately 760 dentists in Alabama and 200 in Ohio. It also insured 114 hospitals and clinics in Alabama, 36 in Indiana, 31 in Ohio, and 38 in other states. In addition, the Company has insured 1,000 allied health workers in Ohio, 860 in Indiana and 1,200 in other states.

The Company markets its professional liability products in Alabama through employees of the Company; however, dental liability policies are marketed through Mutual Assurance Agency, Inc., a wholly owned subsidiary. Outside the state of Alabama, the Company utilizes brokers and independent agents. In Missouri, the Company utilizes employees and brokers to market its products.

### Territory

At December 31, 2002, the Company was licensed to transact business in 44 states and districts as shown below:

Alabama	Idaho	Missouri	Rhode Island
Alaska	Illinois	Montana	South Carolina
Arizona	Indiana	Nebraska	South Dakota
Arkansas	Iowa	Nevada	Tennessee
California	Kansas	New Mexico	Texas
Colorado	Kentucky	North Carolina	Utah
Delaware	Louisiana	North Dakota	Virginia
District of Columbia	Maryland	Ohio	Washington
Florida	Massachusetts	Oklahoma	West Virginia
Georgia	Michigan	Oregon	Wisconsin
Hawaii	Minnesota	Pennsylvania	Wyoming

### **Policy Forms and Underwriting Practices**

Policy files were reviewed during the examination and it was determined that the rates in use were filed and approved by the appropriate Department of Insurance.

### **Dividends to Policyholders**

There were no dividends paid to policyholders during the period covered by this examination.

### **Advertising**

A review was made of the Company's advertising materials used during the period covered by this examination. The Company's advertising material did not misrepresent policy benefit forms or conditions, make unfair or incomplete comparisons with other policies, or make false, deceptive or misleading statements or representations.

### **Claims Review**

It was noted during the examination of the Company's current claims reserves adjustment procedure that in order to make a reserve adjustment, a reserve change form must be completed by a claims representative. The form consisted of the total amount of the new reserve along with an explanation of why reserves were being adjusted. The form would then be forwarded to the administrative assistant to update the computer system used to track policies and claims. The reserve change form would be filed in the master file. After reviewing the sample of claim files, the examiner determined that 21 of the 132 claim files reviewed did not contain a reserve change form to support the reserve adjustment. Per the Company's management, new procedures are being phased in so that all offices will be following the same reserve change procedures.

During a review of the Company's procedures manual, it was determined that guidelines for the use of reservation of rights letter and notice of excess loss did not exist. However, the Senior Vice

President of Claims explained that the Company does not have specific guidelines for use of a reservation of rights letter since the issues pertaining to use of the letters are very specific and varied. The Company's personnel uses the letters whenever there exists a coverage dispute or an allegation by the plaintiff that is not or may not be covered by the policy. In addition, when a new claim file is opened, a notice of excess loss is sent in the initial letter to the insured, advising them in writing that a possibility of exposure beyond their policy limits exists. The insured is advised to seek personal counsel regarding this exposure.

### **Policyholder Complaints**

After reviewing the Company's complaint register, it was determined that the complaint register was not in accordance with the NAIC Market Conduct Examiner's Handbook. The Handbook defines a complaint as "a written communication primarily expressing a grievance." The Handbook requires that the Company record all complaints, both consumers' complaints made directly to the Company and complaints filed with the appropriate Department of Insurance. The Company's complaint register only referenced the complaints filed with the Departments of Insurance.

### **Compliance with Agents' Licensing Requirements**

The examiner reviewed the agents' licensing requirements and determined that the Company was paying commissions to properly licensed producers and agencies.

A Notice of Cancellation for licensing should be sent to the Department of Insurance; however, the Company could not provide proof of the Notice being sent to the Department in five of the cases reviewed.

## **REINSURANCE**

### **Reinsurance Assumed**

At December 31, 2002, the Company had assumed business from two affiliated insurers and from approximately twenty non-affiliated insurers and Lloyd's Syndicates. The Company has elected to exit the reinsurance assumed market for non-affiliates.

At December 31, 2002, the Company was assuming business from non-U.S. insurers and Lloyd's Syndicates. The Company did not demonstrate to the examiners that management had experience in assuming such business. The Company relied on the expertise of a broker to transact business with the non-U.S. insurers and Lloyd's Syndicates, deeming the information received from the broker reasonable.

During a review of a sample of the reinsurance contracts, the examiners noted that the Company had an assumed reinsurance agreement, which did not have all of the provisions attached. The Company was unable to provide such provisions. Therefore, it could not be determined if the Company's insolvency clause for the agreement was in accordance with SSAP No. 62. Also, the Company was unable to provide the signature page of an assumed reinsurance agreement. The

Company should maintain complete copies of its reinsurance agreements in its office and make such agreements readily available for review.

### **Affiliated**

The only material affiliated agreement was with Medical Assurance of West Virginia (MAWV). This contract was entered into as of January 1, 1994, amended January 1, 2000. The Company assumed 100 percent of the liability of policies written by MAWV. At year-end 2002, the Company reported assumed premiums of \$25,719,000, reinsurance on paid losses and loss adjustment expenses of \$3,033,000 and on known case losses and loss adjustment expenses of \$50,437,000.

### **Unaffiliated**

The remaining reinsurance assumed represented less than \$1,000,000 in assumed premiums and approximately \$5,000,000 in known case losses and loss adjustment expenses (LAE) at year-end 2002.

### **Reinsurance Ceded**

At December 31, 2002, the Company's reinsurance ceded programs provided coverage on an excess-of-loss basis, using two layers of reinsurance. Multiple reinsurers participated on each layer including both authorized and unauthorized reinsurers. The Company's retention was \$1 million per claim. The maximum reinsurance coverage provided by the ceding program was \$16 million per claim. If any policy was insured with coverages above the maximum reinsurance coverage, facultative reinsurance was arranged; however, this happened very infrequently. Major participants in the program included Hannover Re, Axa Re, Partner Re and several Lloyd's syndicates. In prior years, a similar program was in place, but retentions and maximum limits varied by year.

The Company's principal reinsurers have generally been obtained through Medical Reinsurance Company, Inc. (MRC), a reinsurance intermediary. The Company relied on MRC to perform periodic audits of the reinsurers in the past. These audits were reviewed during the previous examination. However, the Company was unable to provide copies of the audits performed by MRC during the current examination period. The Company should maintain copies of audits performed on reinsurers utilized by the Company to determine if the reinsurers are providing correct accounting data and if they are complying with the contract provisions.

The Company also had reinsurers that were obtained directly, not through an intermediary or managing general agent. The Company did not audit these reinsurers. However, an audit should be conducted periodically to determine whether the reinsurers were providing correct accounting data and if they were complying with the contract provisions.

During the review of sampled ceded reinsurance agreements, it was noted that the Company had a ceded reinsurance agreement, which did not have all of the provisions attached. The Company was unable to provide such provisions. Therefore, it could not be determined if the Company's insolvency clause for the agreement was acceptable in accordance with SSAP No. 62. It was further noted that the Company was unable to provide the signature page of the lead reinsurer of two ceded

reinsurance agreements. Therefore, it could not be determined if the lead reinsurers signed the reinsurance agreements within nine months in accordance with SSAP No. 62, paragraph 23. The Company should maintain complete copies of its reinsurance agreements in its office and make such agreements readily available for review.

## **ACCOUNTS AND RECORDS**

The Company's principal accounting records were maintained primarily on electronic data processing (EDP) equipment. The Company uses a system to maintain files on claims and underwriting, including premiums. The Company installed a new general ledger system in November 2002. The two systems interface as needed.

The Company was audited annually by the independent certified public accounting firm of Ernst & Young, LLP, (E&Y) Birmingham, Alabama. E&Y conducted all of the Company's audits for the five-year period covered by this examination. As the 2002 audit was being conducted at the same time as the examination, only certain workpapers were made available for review and were utilized in this examination to the extent deemed appropriate.

The actuarial firm of Tillinghast-Towers Perrin, Atlanta, Georgia, was retained by the Company throughout the examination period and prepared the 2002 Statutory Loss Reserve Opinion and the Statement of Actuarial Opinion. The reserve calculations were certified by Mr. James D. Hurley, ACAS, MAAA, a qualified actuary.

Accounting, data processing, clerical and administrative services were provided to ProNational Insurance Company under a management agreement. Further discussion on this agreement and other management and service contracts is included beginning on page 8 in the HOLDING COMPANY AND AFFILIATE MATTERS section of this report, under the caption Management and Service Agreements.

It was noted during the examination of the Company's information system that as of December 31, 2002, the Disaster Recovery Plan had not been fully tested. The Information Systems Department had only tested sections of the plan. The plan should be tested in its entirety to determine if it is reliable or if any modifications should be made. Written test results should be prepared and maintained for the Company's records.

At December 31, 2002, the Company did not have a records retention program in effect that included the Company's electronic data. The Company should have such a program in effect to ensure that adequate records are retained, in accordance with IRS Revenue Procedure 1998.

It was noted that the Company does not maintain written procedural manuals for the Accounting, Underwriting, Information Systems, Premium and Loss departments. When asked, Company contacts were able to provide verbal procedures, however, due to possible personnel turnover; it would be more effective to have written documents that can be used as reference materials.

It was noted that the Company's internal and external audit reports from 1998 through 2002 provided meaningful information to management. However, the Company did not maintain documentation of management's responses to the recommendations of the internal audit reports.

## FINANCIAL STATEMENTS INDEX

The Financial Statements included in this report were prepared on the basis of the Company's records, and the valuations and determinations made during the examination for the year 2002. Amounts shown in the comparative statements for the years 1998, 1999, 2000, and 2001 were compiled from Company copies of filed Annual Statements. The statements are presented in the following order:

Statement of Assets, Liabilities, Surplus and Other Funds.....	21 and 22
Statement of Income.....	23
Capital and Surplus Account.....	24

**FAILURE OF FINANCIAL STATEMENTS TO BALANCE TO INDICATED TOTALS  
IS DUE TO ROUNDING.**

**THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART  
THEREOF.**



**THE MEDICAL ASSURANCE COMPANY, INC.**  
**STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS**  
**For the Year Ended December 31, 2002**

<b><u>ASSETS</u></b>	<b>Ledger Assets</b>	<b>Assets Not Admitted</b>	<b>Net Admitted Assets</b>
Bonds NOTE 1	\$ 511,226,385	\$ 3,508,397	\$ 507,717,988
Preferred stocks	17,120,322		17,120,322
Common stocks NOTE 2	7,023,773	3,980,287	3,043,486
Real estate: Properties occupied	10,595,508		10,595,508
Cash and short-term investments NOTE 3	261,211,715	2,999,037	258,212,678
Other invested assets	9,644,522		9,644,522
Receivable for securities	6,298		6,298
Premiums and agents' balances in course of collection NOTE 4	44,984,542	1,211,862	43,772,680
Premiums, agents' balances and installments booked but deferred and not yet due NOTE 5	28,305,940		28,305,940
Reinsurance recoverables on loss and loss adjustment expense payments NOTE 6	4,660,508	234,286	4,426,222
Federal and foreign income tax recoverable and interest thereon - Parent	45,524,096	26,634,032	18,890,064
Guaranty funds receivable or on deposit	799,465		799,465
Electronic data processing equipment	4,001,657	3,259,520	742,137
Interest, dividends and real estate income due and accrued	6,135,866		6,135,866
Receivable from parent, subsidiaries and affiliates NOTE 7	37,779,847	126,567	37,653,280
Other assets nonadmitted	2,223,803	2,223,803	-
Aggregate write-ins for other than invested assets	1,171,100	1,171,100	-
<b>Totals</b>	<b><u>\$ 992,415,347</u></b>	<b><u>\$ 45,348,891</u></b>	<b><u>\$ 947,066,456</u></b>

**THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART  
THEREOF.**

**THE MEDICAL ASSURANCE COMPANY, INC.**  
**STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS**  
**For the Year Ended December 31, 2002**

**LIABILITIES**

Losses NOTE 8	\$ 240,335,487
Reinsurance payable on paid loss and loss adjustment expenses	3,032,965
Loss adjustment expenses NOTE 8	325,595,327
Commissions payable, contingent commissions and other similar charges NOTE 9	5,612,685
Other expenses NOTE 10	6,542,319
Taxes, licenses and fees	2,213,976
Unearned premium	120,525,332
Advanced premiums	2,327,817
Ceded reinsurance premiums payable (net of ceding commission)	50,763,361
Amounts withheld or retained by company for account of others NOTE 11	605,372
Provision for reinsurance NOTE 12	6,296,973
Payable for securities	2,329,372
Payable to parent, subsidiaries and affiliates NOTE 13	62,170
Premium deficiency reserve NOTE 14	-
<b>TOTAL LIABILITIES</b>	<b><u>\$ 766,243,156</u></b>

**CAPITAL AND SURPLUS**

Common capital stock NOTE 15	\$ 8,972,237
Gross paid in and contributed surplus	165,427,959
Unassigned funds (surplus) NOTE 16	6,423,104
Surplus as regards to policyholders	<u>\$ 180,823,300</u>
<b>TOTAL LIABILITIES, CAPITAL AND SURPLUS</b>	<b><u>\$ 947,066,456</u></b>

**THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART  
THEREOF.**

**THE MEDICAL ASSURANCE COMPANY, INC.**  
**STATEMENT OF INCOME**  
**For the Years Ended December 31, 1998, 1999, 2000, 2001, and 2002**

	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
<b><u>Underwriting income</u></b>					
Premiums earned	\$ 140,025,571	\$ 164,116,311	\$ 187,591,444	\$ 183,746,186	\$ 185,456,783
<b><u>Deductions:</u></b>					
Losses incurred	\$ 23,555,920	\$ 24,874,661	\$ 40,726,452	\$ 84,393,685	\$ 85,125,978
Loss expenses incurred	71,310,140	74,563,977	122,179,364	109,901,297	118,381,956
Other underwriting expenses incurred	<u>39,813,816</u>	<u>40,974,378</u>	<u>45,926,986</u>	<u>41,305,991</u>	<u>34,900,070</u>
Total underwriting deductions	\$ 134,679,876	\$ 140,413,016	\$ 208,832,802	\$ 235,600,973	\$ 238,408,004
Net underwriting gain	\$ 5,345,695	\$ 23,703,295	\$ (21,241,358)	\$ (51,854,787)	\$ (52,951,221)
<b><u>Investment income</u></b>					
Net investment income earned	\$ 31,972,893	\$ 32,571,170	\$ 39,008,490	\$ 37,285,118	\$ 36,558,108
Net realized capital gains or (losses)	<u>9,358,746</u>	<u>931,259</u>	<u>(17,696,113)</u>	<u>3,910,198</u>	<u>(2,659,367)</u>
Net investment gain or (loss)	\$ 41,331,639	\$ 33,502,429	\$ 21,312,377	\$ 41,195,316	\$ 33,898,741
<b><u>Other income</u></b>					
Other miscellaneous income	\$ 364,855	\$ 1,351,917	\$ 1,083,825	\$ 278,206	\$ 694,700
Net income before federal and foreign income taxes	47,042,189	58,557,641	1,154,844	(10,381,265)	(18,357,780)
Federal and foreign income taxes incurred	<u>\$ 14,552,928</u>	<u>\$ 8,472,199</u>	<u>\$ 800,999</u>	<u>\$ (4,506,774)</u>	<u>\$ 737,869</u>
<b>NET INCOME</b>	<u>\$ 32,489,261</u>	<u>\$ 50,085,442</u>	<u>\$ 353,845</u>	<u>\$ (5,874,491)</u>	<u>\$ (19,095,649)</u>

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART  
THEREOF.

**THE MEDICAL ASSURANCE COMPANY, INC.**  
**CAPITAL AND SURPLUS ACCOUNT**  
**For the Years Ended December 31, 1998, 1999, 2000, 2001, and 2002**

	1998	1999	2000	2001	2002
Surplus as regards policyholders, December 31, prior year	<u>\$ 165,321,242</u>	<u>\$ 193,689,709</u>	<u>\$ 254,905,493</u>	<u>\$ 208,805,112</u>	<u>\$ 172,840,696</u>
<b>Gains and (losses) in surplus</b>					
Net income	\$ 32,489,261	\$ 50,085,442	\$ 353,845	\$ (5,874,491)	\$ (19,095,649)
Net realized capital gains and losses	1,278,932	(8,934,186)	1,025,301	(3,868,210)	7,149,643
Change in net deferred tax income				(1,012,563)	6,921,052
Change in nonadmitted assets	3,105,214	(1,211,958)	808,458	5,514,947	(14,529,816)
Change in provision for reinsurance	6,591,560	(505,000)	(656,000)	(2,000,000)	(3,102,973)
Changes in excess of statutory reserves over statement reserves	(96,500)	(1,549,500)	1,443,000		
Cumulative effect of changes in accounting principles				16,275,901	
Paid in surplus					36,000,000
Surplus transferred to capital					
Dividends to stockholders	15,000,000	20,000,000	50,000,000	45,000,000	
Change in treasury stock					
Aggregate write-ins for gains and losses in surplus					(5,359,653)
Miscellaneous	-	-	925,016	-	-
Change in surplus as regards policyholders for the year	<u>\$ 28,368,467</u>	<u>\$ 17,884,798</u>	<u>\$ (46,100,380)</u>	<u>\$ (35,964,416)</u>	<u>\$ 7,982,604</u>
Surplus as regards policyholders, December 31, current year	<u>\$ 193,689,709</u>	<u>\$ 211,574,507</u>	<u>\$ 208,805,113</u>	<u>\$ 172,840,696</u>	<u>\$ 180,823,300</u>

**THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART  
THEREOF.**

## NOTES TO FINANCIAL STATEMENTS

### Note 1 - Bonds

\$507,717,988

The above captioned amount is \$3,508,397 less than \$511,226,385 reported on the 2002 Annual Statement.

Alabama Department of Insurance Regulation Number 98 Section 2.A. states, "All securities owned by an insurer shall be valued in accordance with those standards promulgated by the NAIC Securities Valuation Office (SVO). Any securities owned by the insurer that have not been valued shall be submitted to the SVO for valuation in accordance with the procedures of the SVO." Section 2.C. states, "Any security not valued in accordance with this section shall be carried as a non-admitted asset on all financial statements of the insurer until such time as the insurer has complied with subsection A or B of this section." The NAIC Annual Statement Instructions state that the Company should use the NAIC designation for securities that is included in the *NAIC Valuation of Securities*. It also states that any security designation, which is entered by the insurer under its own judgment, shall have the letter "Z" appended. The Purposes and Procedures Manual of the NAIC Securities Valuation Office states that securities with a "Z" designation must be submitted to the SVO for valuation within 120 days of the date the security was acquired. The Company listed two securities with a "Z" designation that had been acquired past the 120 day cutoff. The Denison Texas security, with a carrying value of \$995,326, was purchased April 8, 1997, and was never submitted to the SVO for valuation. The Company sold this security in February 2003. The Connector 2000 security, with a carrying value of \$1,864,101, was purchased February 11, 1998, and was recently submitted to the SVO. As the Company did not file these securities as required, they were non-admitted.

The Company listed thirty-eight securities on the 2002 Annual Statement with the incorrect NAIC SVO designations. Thirty-three of the securities were provisionally exempt and did not include the proper "PE" designation on Schedule D - Part 1. Three other securities were given a higher designation by the Company than that listed by the SVO. Of these three securities, the Company had a Pocahontas Parkway bond with a carrying value was \$648,970, that was rated a 3 on Schedule D - Part 1. The Company stated that this security should have been rated as 6\*. The Purposes and Procedures Manual of the NAIC Securities Valuation Office states if an insurer intends to report a security on its annual financial statement with a NAIC 6\* designation and a unit price greater than zero, they are required to file a Principal and Interest Certification Form for the security with the SVO. The Company did not file the necessary form with the SVO; therefore, this security was non-admitted.

It was noted that the Company did not report the correct CUSIP number on eight of its bonds when preparing Schedule D. The NAIC Annual Statement Instructions require that all CUSIP numbers entered into Column 1 of Schedule D must conform to those as published by the SVO.

The Company stated that it used fair values obtained from the SVO CD-ROM and broker statements rather than from an independent pricing service or investment manager as required by the NAIC when completing Schedule DM. Therefore, Schedule DM was not appropriately completed.

**Note 2 – Common stocks****\$3,043,486**

The above captioned amount is \$3,980,287 less than the \$7,023,773 reported on the 2002 Annual Statement.

Alabama Department of Insurance Regulation Number 98 Section 2.A. states, “All securities owned by an insurer shall be valued in accordance with those standards promulgated by the NAIC Securities Valuation Office.” The Purposes and Procedures Manual of the NAIC Securities Valuation Office, Part Eight, Section 1 states that the Company must report any Subsidiary, Controlled and Affiliated (SCA) Investments purchased during one calendar year by filing a SUB 1-form within thirty days of the acquisition. It also states that the Company is to file a SUB 2-form by June of each following year as this allows the SVO SCA Companies Group to approve a value for the transaction. It was noted during the examination that the Company had not filed SUB 1-form or SUB 2-form filings on its SCA investments for the years under examination. Prior to Codification, January 1, 2001, the Company valued these investments at zero and did not file SUB 1-form and SUB 2-form, but after Codification the Company believed that it could carry the investments at value without submitting the forms. According to the Associate Credit Manager of the NAIC, the Company should file a SUB 1-form for Mutual Assurance Agency, Inc., which was valued by the Company at \$1,450,690. In addition, the Associate Credit Manager stated that the Company needed to complete a Treasury Stock and Reciprocal Ownership Elimination Worksheet for ProAssurance Corporation common stock, which was valued by the Company at \$2,529,597, to determine the amount of elimination for filing the SUB 1-form for this security. Subsequent to the examination date, the Company filed SUB 1-forms on Mutual Assurance Agency, Inc. and on ProAssurance Corporation, but the valuations had not been received at the writing of this report. Therefore, the investments were non-admitted.

**Note 3 – Cash and short-term investments****\$258,212,678**

The above captioned amount is \$2,999,037 less than the \$261,211,715 reported in the 2002 Annual Statement.

SSAP No. 4, paragraph 2 states that an asset has three essential characteristics: a) it embodies a probable future benefit that involves a capacity to contribute directly or indirectly to future net cash inflows; b) the particular entity can obtain the benefit and control others' access to it; and c) the transaction or other event giving rise to the entity's right to control of the benefit has already occurred. It was noted that the Company has established trust accounts for assumed reinsurance, which had more securities pledged than the recorded reserves in an excess of \$2,999,037. These pledged amounts did not meet the characteristics of b) and c) above and were not specifically identified as an admitted asset within the NAIC Accounting Practices and Procedures Manual. SSAP No. 4, paragraph 3 states, “Assets having economic value other than those which can be used to fulfill policyholders obligations, or those assets which are unavailable due to encumbrances or other third-party interest should not be recognized on the balance sheet and are, therefore, considered non-admitted.” ALA. CODE §27-37-3 (1975) states, “Assets may be allowed as deductions from corresponding liabilities, and liabilities may be charged as deductions from assets and deductions from assets may be charged as liabilities in accordance with the form of an annual statement applicable to the insurer as prescribed by the commissioner or otherwise at his

discretion.” In addition, ALA. CODE §27-37-4(b)(2) (1975) states, “The commissioner shall disallow as an asset any deposit, funds, or other assets of the insurer found by him after a hearing thereon: ...Not freely subject to withdrawal or liquidation by the insurer at any time for the payment or discharge of claims or other obligations arising under its policies; and ....” Even though this amount was immaterial, the total of all unadjusted items was material. Therefore, the financial statements were changed.

- The Company listed two Class One Money Market Mutual Funds on Schedule DA - Part 1. The description listed by the Company did not match that of the List of Money Market Funds Filed with the Securities Valuation Office (SVO) that is found in Section 9 of the Appendix to the Purposes and Procedures Manual of the NAIC Securities Valuation Office. In addition, the Company did not use the correct CUSIP numbers when reporting these funds on Schedule DA - Part 1.

It was noted during the examination of the Company’s repurchase agreements that according to SSAP No. 45, paragraph 8 (a), the reporting entity shall receive as collateral transferred securities having a fair value of at least equal to 102 percent of the purchase price paid by the reporting entity for the securities. If at anytime the fair value of the collateral is less than 100 percent of the purchase price paid by the reporting entity, the counterparty shall be obligated to provide additional collateral, the fair value of which, together with fair value of all collateral then held in connection with the transaction, at least equals 102 percent of the purchase price. The fair value of the Company’s overnight repurchase agreement, at December 31, 2002, was \$4,798,013 with a purchase price of \$4,798,000. Therefore, the fair value of the collateral should have been \$4,893,960 (102 percent of \$4,798,000).

**Note 4 - Premiums and agents’ balances in course of collection**

**\$43,772,680**

The above captioned amount is \$2,151,171 more than the \$41,261,509 reported in the 2002 Annual Statement.

At December 31, 2002, the Company reported \$42,833,372 as the gross amount for this line item. The amount should be \$6,298,961 more due to the Company reporting an incorrect amount for invoiced core business. This difference was incorrectly included under the Premiums, agents’ balances and installments booked but deferred and not yet due (Premiums booked). In addition, the Company should have reflected \$1,211,862 of delinquent premiums (90 days and over) in the gross amount, which was included in error under Premiums booked. The NAIC Annual Statement Instructions state to include “Receivable amounts due” under Premiums and agents’ balances in course of collection. The Company also included \$5,359,653 in the gross amount, which was later non-admitted. However, it was determined that this amount contained income items that should have been written off through the Capital and Surplus Account on the line “Aggregate write-ins for gains and losses in surplus” in accordance with the NAIC Annual Statement Instructions and should not have been included in the gross amount for this line item. The gross amount for this line item should reflect \$44,984,542 due to the above corrections. The Company correctly non-admitted the \$1,211,862 of delinquent premiums.

The \$5,359,653 correction disclosed in the prior paragraph should have been disclosed in the 2002 Annual Statement, Notes to Financial Statements. The NAIC Annual Statement Instructions state

to describe material changes in accounting principles and/or correction of errors in Number 2, Accounting Changes and Corrections of Errors.

At December 31, 2002, the Company reported \$148,115 and \$138,465 for agents' balances or uncollected premiums (receivables) on Indiana's multiline business and on Alabama's and Georgia's workers' compensation and professional office package businesses, respectively. The amount reported in Premiums and agents' balances in course of collection was 25 percent of the receivables. The Company used 25 percent as an estimate at year-end. These amounts were not calculated on a policy basis. The Company should report actual amounts for Premiums and agents' balances in course of collection. This was corrected in the June 2003 Quarterly Statement.

**Note 5 - Premiums, agents' balances and installments  
booked but deferred and not yet due**

**\$28,305,940**

The above captioned amount is \$2,151,171 less than the \$30,457,111 reported on the Asset Statement.

At December 31, 2002, the Company reported \$35,816,764 as the gross amount for this line item. The Company reported \$6,298,961 in unbilled amount for its core business, which should have been included in Premiums and agents' balances in course of collection, as the \$1,211,862 for delinquent premiums (90 days and over) should have been. The NAIC Annual Statement Instructions state to include "Receivable amounts not yet due" for Premiums, agents' balances and installments booked but deferred and not yet due. The gross amount for this line item should reflect \$28,305,940. There were no non-admitted amounts for this line item. Therefore, the Net Admitted column should reflect \$28,305,940.

At December 31, 2002, the Company reported \$148,115 and \$138,465 for agents' balances or uncollected premiums (receivables) on Indiana's multiline business and on Alabama's and Georgia's workers' compensation and professional office package businesses, respectively. The amount reported in Premiums, agents' balances and installments booked but not yet due was 75 percent of the receivables. The Company used 75 percent as an estimate at year-end. These amounts were not calculated on a policy basis. The Company should report actual amounts for Premiums and agents' balances and installment booked but deferred and not yet due. This was corrected as of the June 2003 Quarterly Statement.

**Note 6 - Reinsurance recoverables on loss and  
loss adjustment expense payments**

**\$4,426,222**

The above captioned amount is \$234,286 less than the \$4,660,508 reported in the 2002 Annual Statement.

At December 31, 2002, the Company overstated reinsurance recoverables by \$234,286. The Company failed to recalculate the recoverable due to an adjustment agreed upon with a reinsurer prior to year-end. Even though this amount was immaterial, the total of all unadjusted items was material. Therefore, the financial statements were changed.



Section D of Number 22 of the Notes to Financial Statements, which concerned uncollectible reinsurance, was not included in the 2002 Annual Statement, as required by the NAIC Annual Statement Instructions and SSAP No. 62, paragraph 67. It was noted that the Company did have reinsurance recoverables, which were written off at December 31, 2002. In addition, \$234,286, as discussed above, should have been written off at year-end. At December 31, 2002, the Company was in agreement with the reinsurer that the balance owed by the reinsurer would be written off. Therefore, this should have been disclosed in the Notes to Financial Statements Number 22D.

**Note 7 - Receivable from parent, subsidiaries and affiliates**

**\$37,653,280**

The above captioned amount is \$64,397 less than the \$37,717,677 reported on the 2002 Annual Statement.

At December 31, 2002, the Company netted \$62,170 of Payables from parent, subsidiaries and affiliates from the \$37,779,847 of Receivable from parent, subsidiaries and affiliates. These amounts should have been reported separately in accordance with the NAIC Annual Statement Instructions and SSAP No. 64. Therefore, the Receivable from parent, subsidiaries and affiliates increased \$62,170. Included in the Receivable from parent, subsidiaries and affiliates was an equity balance of 100 percent ownership of Mutual Assurance Agency of Ohio of \$87,790. The NAIC Annual Statement Instructions state to include "unsecured current accounts receivable from parent, subsidiaries and affiliates." Therefore this amount should not have been included. Also included in this line item was a receivable in the amount of \$38,777 from Medical Assurance of West Virginia (MAWV). MAWV and the Company did not have a management and service agreement, and with the Company making payments on behalf of MAWV, there was no documentation evidencing that the amount was owed by MAWV at December 31, 2002. Therefore, this amount should be non-admitted. The above changes reduced Receivable from parent, subsidiaries and affiliates to \$37,653,280.

**Receivable from parent, subsidiaries and affiliates  
Companies**

	<b>Receivables</b>
^^ Equity balance	\$ 87,790
Medical Assurance, Inc.	36,006,489
**Medical Assurance of West Virginia, Inc.	38,777
Professional Group, Inc.	82,806
ProNational Insurance Company	1,563,484
Red Mountain Casualty Company	500
<b><i>Total after the \$62,170 reclassification</i></b>	<b><i>\$37,779,847</i></b>

Non-admit the following

^^Equity balances	87,790
**Medical Assurance of West Virginia, Inc.	38,777
Non-admitted Total	126,567
<b><i>Total after non-admitting</i></b>	<b><i>\$37,653,280</i></b>

\*\* = No supporting documentation

^^ = This balance does not belong in the line item

**Note 8 – Losses**

**Loss adjustment expenses**

**\$240,335,487**

**\$325,595,327**

The above captioned amounts are the same as reported in the 2002 Annual Statement.

It was noted that the gross and net of reinsurance loss and loss adjustment expense (LAE) reserves booked by the Company were approximately \$14.7 million and \$19.9 million, respectively, less than the Company's opining actuary's estimates for loss and LAE reserves.

The consulting actuary, retained by the Alabama Department of Insurance for this examination, concluded that the gross and net of reinsurance ceded loss, LAE and unallocated loss adjustment expenses (ULAE) reserves booked by the Company fell within a reasonable range of the opining actuary's reserve estimates.

The consulting actuary found that the booked gross loss and LAE reserves on the Company core medical malpractice liability lines of business were approximately \$13 million less than the opining actuary's estimates. In addition, the consulting actuary found that the booked gross loss and LAE reserves for the other lines of business were approximately \$0.1 million more than the opining actuary's estimates. The consulting actuary also found that the booked gross loss and allocated loss adjustment expenses (ALAE) reserves were \$1.8 million less than the opining actuary's estimates due to an entry reversal prepared by the Company attributable to the Company's participation in the pooling activities of the Health Care Insurance Facility (HCIF). HCIF was a pooling arrangement whereby a small number of companies participated in the medical malpractice reinsurance assumed market. The pool consisted of a small percentage of exposures that were initially written by a small number of different direct companies or that were acquired by reinsurance programs. The Company was a direct writer of some of the exposures that ultimately became part of the exposures of the pool and were assumed by the Company under the program, so an entry reversal was prepared to correct for this double accounting. The Company made this entry after the reserve information was transmitted to the opining actuary; therefore, the gross loss and ALAE reserves reported in the opining actuary's report were overstated by approximately \$1.8 million. In summary, the reduction of \$13.0 million, the increase of \$0.1 million and the reduction of \$1.8 million resulted in a total reduction of \$14.7 million in the booked gross loss and LAE reserves in comparison to the opining actuary's estimates.

The consulting actuary found that the booked reinsurance ceded loss and LAE reserves were approximately \$5 million more than the opining actuary's estimates. This difference was due to a \$6.8 million increase in the analysis of the Company's core medical malpractice liability lines of business by the Company's actuarial department, as discussed in the previous paragraph. The consulting actuary found that the booked reinsurance ceded loss and LAE reserves were approximately \$1.8 million less than the opining actuary's estimates due to the HCIF situation discussed in the previous paragraph. Overall, the \$14.7 million decrease in the booked gross loss and LAE reserves, the \$5 million increase in the booked reinsurance ceded loss and LAE reserves, plus a \$0.2 million attributable to rounding, resulting in the total reduction of \$19.9 million in the booked net of reinsurance ceded loss and LAE reserves in comparison to the opining actuary's estimated net of reinsurance ceded loss and LAE reserves.

**Note 9 - Commissions payable, contingent commissions and other similar charges**

**\$5,612,685**

The above captioned amount is the same as the amount reported in the 2002 Annual Statement.

At December 31, 2002, the Company included in its year-end liability some commissions, which did not match the rate per the commission agreements. It was noted that these agents were paid a higher than contracted commission rate amount on certain occurrence business that had been converted to claims-made. Per the Company, the reason for the increases was to cause the actual amount of commission paid during the conversion process to approximate the former occurrence commission. However, the commission agreements were not amended to reflect such increase in the commission rate. The Company should pay the commission rate listed in the commission agreement or amend its commission agreement to reflect the correct commission rate.

**Note 10 – Other expenses**

**\$6,542,319**

The above captioned amount is \$565,951 less than the \$7,108,270 reported in the 2002 Annual Statement.

It was noted that the Company included Unclaimed Property in the amount of \$565,951 in Other expenses. The NAIC Annual Statement Instructions state that any other funds that the Company holds in a fiduciary capacity for the account of others should be included in Amounts withheld or retained by company for account of others. The financial statements were changed to reflect this reclassification.

**Note 11 - Amounts withheld or retained by company for account of others**

**\$605,372**

The above captioned amount is \$565,951 more than the \$39,421 reported on the 2002 Annual Statement.

It was noted that the Company included Unclaimed Property in the amount of \$565,951 in Other expenses. The NAIC Annual Statement Instructions state that any other funds that the Company holds in a fiduciary capacity for the account of others should be included in this line item. This reclassification was made to the financial statements.

At December 31, 2002, the Company had \$28,525 of Alabama Unclaimed property that was held for over five years. ALA. CODE §35-12-27 (1975) requires the Company to deposit with the State Treasurer funds that are unclaimed for over five years.

**Note 12 – Provision for reinsurance**

**\$6,296,973**

The above captioned amount is \$1,662,773 more than the \$4,634,200 reported on the 2002 Annual Statement.

At December 31, 2002, ProNational Insurance Company (ProNational) was an unauthorized reinsurer due to surrendering its Alabama license in order to operate as an excess and surplus carrier in Alabama. However, ProNational was not included on Schedule F - Part 5, Provision for Unauthorized Reinsurance, of the 2002 Annual Statement, in accordance with the NAIC Annual Statement Instructions. The total provision for unauthorized reinsurance increased by \$317,000 when ProNational was added to this schedule. In 2003, ProNational did provide funds to be held by the Company. London Life Reinsurance Company was an authorized company at December 31, 2002. The Company had listed this reinsurer as unauthorized and included it on Schedule F - Part 5, Provision for Unauthorized Reinsurance in error. This schedule was corrected excluding London Life Reinsurance Company. The total provision for unauthorized reinsurance decreased \$5,000 due to this error. At December 31, 2002, the Company reported a Trust Agreement as a reserve credit for reinsurer APAL on Schedule F - Part 5. This Trust Agreement, in the amount of \$1,269,000, was determined not to be in compliance with ALA. CODE §27-5-12(iv)4 (1975) and Alabama Department of Insurance Regulation Number 105, which states that the trustee of a trust agreement must be a qualified U.S. financial institution. This trust agreement's trustee, Prudential Financial, is not a U.S. qualified financial institution, as defined under ALA. CODE §27-5-12(iv)4 (1975). Therefore, this trust agreement was removed from Schedule F - Part 5, Provision for Unauthorized Reinsurance. By removing the agreement, the total provision for unauthorized reinsurance for this APAL increased \$1,269,000. The Company reported the trust agreement reserve credits on Schedule F - Part 5 under the Letter of Credit column. The NAIC Annual Statement Instructions state to "report trust funds and other acceptable security" under column 10, Other Allowed Offset Items. Even though these agreements were reported under the incorrect column, it did not effect the Provision for Unauthorized Reinsurance balance. The above corrections increased the Provision for Unauthorized Reinsurance from \$1,581,000 to \$6,101,000.

At December 31, 2002, there was one reinsurance recoverable claim in the amount of \$669,592, which was in dispute. The Company received written communication from Medical Reinsurance Company, Inc. that the Reinsurer disputed the remaining amount owed on a claim and was prepared to arbitrate the matter. However, the Company did not disclose the disputed amount on the Provision for reinsurance. The NAIC Annual Statement Instructions state that when completing Schedule F - Part 6, "Reinsurance recoverables on paid and unpaid (including IBNR) loss in dispute by reason of notification, arbitration or litigation should be excluded from Columns 4 and 5." Disputed amounts should be included in Column 9. SSAP No. 62, paragraph 55 states that "items in dispute are those claims with respect to which the ceding entity has received formal written communication from the reinsurer denying the validity of coverage." This schedule was corrected to reflect this adjustment. The Company was aware at December 31, 2002 that \$234,286 of a claim was uncollectible. However, this uncollectible reinsurance amount was not written off at year-end and was included in the reinsurance recoverable amount. Therefore, that amount was included on the Provision for reinsurance. The uncollectible reinsurance balance should have been written off through the accounts, exhibits and schedules in which it was originally recorded in accordance with SSAP No. 62, paragraph 56. The above corrections increased the Provision for Overdue Authorized Reinsurance from \$81,773 to \$195,973.

<b>Schedule F - Part 5</b>	
<i>Provision for Unauthorized Reinsurance</i>	
<i>Reported Total</i>	\$4,520,000
Exclude London Life from schedule	(\$5,000)
Exclude APAL Trust Agreement	\$1,269,000
Include ProNational Insurance	\$317,000
<b>New Total</b>	<b>\$6,101,000</b>
<b>Schedule F - Part 6</b>	
<i>Provision for Overdue Authorized Reinsurance</i>	
<i>Reported Total</i>	\$114,200
Changes due to disputed amount of \$669,592	
and written off amount of \$234,287	\$ 81,773
<b>New Total</b>	<b>\$195,973</b>
<b>Schedule F - Part 7</b>	
<i>Provision for Overdue Reinsurance</i>	
<i>Reported Total</i>	\$0
No Changes	\$0
<b>Total</b>	<b>\$0</b>
<b>Provision for Reinsurance</b>	
Schedule F - Part 5	\$6,101,000
Schedule F - Part 6	\$195,973
Schedule F - Part 7	\$0
<b>Total</b>	<b>\$6,296,973</b>

**Note 13 – Payable to parent, subsidiaries and affiliates**

**\$62,170**

The above captioned amount is \$62,170 more than the \$0 reported on the 2002 Annual Statement.

At December 31, 2002, the Company netted the payables from parent, subsidiaries and affiliates from the receivables from parent, subsidiaries and affiliates. These amounts should have been reported separately in accordance with the NAIC Annual Statement Instructions and SSAP No. 64. The Company had a payable to Mutual Assurance Agency, Inc. in the amount of \$31,296 and a payable to ProAssurance Corporation for \$30,874. The total of these payables was \$62,170, which was reclassified from Receivable from parent, subsidiaries and affiliates.

The Company did not have a Management and Services Agreement with Mutual Assurance Agency, Inc. (Mutual) at December 31, 2002. With Mutual making payments on behalf of the Company, there was no documentation evidencing that the amount was owed by the Company.

**Note 14 – Premium deficiency reserve**

**\$0**

The above captioned amount is the same as reported in the 2002 Annual Statement.

At December 31, 2002, the Company reported a zero premium deficiency reserve. SSAP 53, paragraphs 15 and 16 requires that the Company determine if a reserve should be established and provides a method for its calculation. The Company had not prepared formal workpapers supporting such amount, but the reserve was determined to be reasonable by the consulting actuary.

**Note 15 – Common capital stock**

**\$8,972,237**

The above referenced amount is the same as reported in the 2002 Annual Statement.

On May 10, 2001, the Company's parent, Medical Assurance, Inc., used the Company's capital stock as collateral for a \$110 million credit agreement between ProAssurance Corporation (ProAssurance) and SouthTrust Bank. The agreement states that ProAssurance shall pay the principal amount of the loan over a five-year term in minimum quarterly installments of \$2.5 million and in annual installments beginning 2002 equal to the lesser of the amount by which 50 percent of the annual net cash flow of ProAssurance exceeds the minimum quarterly payments for such year (\$10 million) or \$15 million. It was determined that ProAssurance was in compliance with such agreement on December 31, 2002. At that date the balance of the credit agreement was \$72.5 million. ProAssurance had paid a total of \$37.5 million. The outstanding balance of the loan was paid in full on July 23, 2003.

According to the 2002 Annual Statement, the Company had 12,000,000 shares of common stock with 8,972,237 shares outstanding and issued to the parent company, Medical Assurance, Inc. The remaining 3,027,763 shares were controlled by the Board of Directors. The examiner reviewed the stock register. There were 8,846,429 shares of common stock issued to Medical Assurance, Inc. (formerly known as MAIC Holdings, Inc.). It was determined in the previous examination that the Company incorrectly transferred \$125,808 from paid in and contributed surplus to common capital stock. The \$125,808 was the difference between what was reported in the Annual Statement and what was reported in the stock register. At December 31, 2002, the Company was unable to provide documentation that the outstanding stock reconciled to the general ledger. The Company corrected this error as of June 30, 2003.

**Note 16 – Unassigned funds (surplus)**

**\$6,423,104**

The above captioned amount is \$12,511,347 less than the \$18,934,451 reported in the 2002 Annual Statement.

The following is a summary of the adjustments made within the report:

**Assets: Increase/(Decrease)**

Bonds	\$( 3,508,397)
Common stocks	( 3,980,287)
Cash and short-term investments	( 2,999,037)
Premiums and agents' balances in course of collection	2,151,171
Premiums, agents' balances and installments booked but deferred and not yet due	( 2,151,171)
Reinsurance recoverable on loss and loss adjustment expense payments	( 234,286)

Receivable from parent, subsidiaries and affiliates	( 64,397)
<b>Total Assets</b>	<b><u>\$(10,786,404)</u></b>
<b>Liabilities: (Increase)/Decrease</b>	
Other expenses	\$ 565,951
Amounts withheld or retained by company for account of others	( 565,951)
Provision for reinsurance	( 1,662,773)
Payable to parent, subsidiaries and affiliates	( 62,170)
<b>Total Liabilities</b>	<b><u>\$( 1,724,943)</u></b>
<b>Total Adjusted Items</b>	<b><u>\$(12,511,347)</u></b>

## CONTINGENT LIABILITIES AND PENDING LITIGATION

The review of contingent liabilities and pending litigation included an inspection of representations made by management to the Company's independent certified public accountants regarding the Company and its subsidiaries, a review of the report on litigation and claims made by the Company counsel to the Company's independent certified public accountants, a review of a report to the examiners on pending litigation made by Company counsel, and a general review of the Company's records and files conducted during the course of the examination including a review of claims. These reviews did not disclose any items that would have a material effect on the Company's financial condition in the event of an adverse outcome.

## PRIVACY STANDARDS

The examiners reviewed the Company's privacy procedures and found the following:

1. The Company does not have a formal training manual. However, the Company does instruct its employees as to the normal procedures for day-to-day handling of nonpublic personal information. The information is distributed in the normal course of the Company's business to internal and affiliated persons only.
2. The Company does not accept an application unless the potential policyholder has signed an initial privacy notice.
3. The Company sends out annual privacy notices to its policyholders.
4. The Company relays privacy information as a part of the Company's webpage.
5. The Company does not disclose any nonpublic information on its policyholders unless required by law. This includes personal health or financial information. For this reason, the Company does not need to provide opt-out statements to its policyholders.

Overall, the examiners determined that the Company was following the privacy procedures and standards contained in ALA. ADMIN. CODE 482-1-122 (2001).

## SUBSEQUENT EVENTS

The following two agreements were signed subsequent to the balance sheet date:

(A) Management Service Agreement between the Company, Red Mountain Casualty Insurance Company, Inc. and ProNational Insurance Company effective January 1, 2003. The Company shall be responsible for coordinating the delivery of management services as Manager. The Company shall deploy the employees of the Company and ProNational as required to provide the management services, which includes accounting services, financial statements and tax returns; underwriting; reinsurance; sales and service; claims administration; information systems; administrative and other services; risk management; and delegation of duties whereby the Company will use employees or engage consultants, advisors, investment managers and such other third-parties as required. Allocations of direct and indirect expenses were set forth in the Expense Allocation Agreement discussed below.

(B) Expense Allocation Agreement between the Company, ProNational Insurance Company, Red Mountain Casualty Insurance Company, Inc., Medical Assurance, Inc., Professionals Group, Inc. and ProAssurance Corporation effective January 1, 2003. Direct expenses shall be allocated to the company incurring the expenses. Indirect expenses shall be allocated in a fair and reasonable method in conformity with customary insurance accounting practices to be consistently applied. The allocations shall be settled on a quarterly basis.

Per the Company's Investment Policy, the Board of Directors has designated the Chief Executive Officer, Chief Operating Officer, Chief Financial Officer and Chief Accounting Officer as Administrators to administer the investment management process. The Administrators shall serve as the Investment Committee and shall provide quarterly investment reports to the Board. ALA. CODE §27-41-5 (1975) states that regular reports of investments shall be submitted to the Board of Directors. As of June 26, 2003, the ProAssurance Corporation's Investment Committee had not provided investment reports to the Board of Directors. However, the Board had not met during this time period for the Investment Committee to give a report.

The Company stated that during the 4th quarter of 2002, it initiated a sale program of \$250,000,000 in bonds. Not all proceeds were reinvested immediately. As of December 31, 2002, the Company held a substantial portion of that sale program in cash and cash equivalents. However, the cash was reinvested by the end of the first quarter 2003. The bonds that were purchased were listed on Schedule D - Part 3 of the March 2003 Quarterly Statement. All investments fell within the provisions set forth in the Company's Investment Policy.

## **COMPLIANCE WITH PREVIOUS RECOMMENDATIONS**

A review was conducted during the current examination with regard to the Company's compliance with the recommendations made in the previous examination report. This review indicated that the Company had complied with the prior recommendations, with the following exceptions:

Conflict of interest – The previous examination report recommended that the officers and directors of the Company complete the conflict of interest statements in the manner prescribed by the statements. This examination determined that certain officers and directors did not complete the conflict of interest statements in accordance with the requirements of the statement policy. A recommendation is included in this examination report at page 37.



Common stocks – The Company did not comply with the previous recommendation regarding the valuation of common stock in a parent, subsidiary and/or affiliate in accordance with Alabama Department of Regulation Number 98. See the recommendation on page 39 of this report.

Amounts withheld or retained by company for account of others – The previous examination report recommended that the Company remit funds to the commissioner of revenue in accordance with ALA. CODA §35-12-23 (1975). The review of unclaimed property filings with the Alabama State Treasurer's office indicated that the recommendation had not been complied with in its entirety. See page 41 of this examination report for the recommendation.

Provision for reinsurance – The previous examination report recommended that the Company not list reinsurers as authorized when they are not. This report recommended that the Company include all unauthorized reinsurers on Schedule F. See page 41 for the recommendation.

Common capital stock – In the previous examination report it was recommended that the Company correct the error between paid in and contributed surplus to common capital stock. See page 42 for the recommendation.

## **IMPORTANT POINTS, COMMENTS AND RECOMMENDATIONS**

The following summary presents the important points, comments and recommendations that are made in the current report of examination.

### **Conflicts of Interest – Page 7**

**It is recommended** that directors, officers and other employees sign the Conflicts of Interest Statement every year in accordance with the Statement of Policy on Conflicts of Interest.

### **Employee and Agent Welfare – Page 13**

**It is recommended** that the Company determine if any prohibited persons, as defined in the Violent Crime Control & Law Enforcement Act of 1994, U.S. Code, Section 1033, are employed or may be employed by the Company.

### **Claims Review – Page 16**

**It is recommended** that the Company maintain guidelines for the reservation of rights letter and notice of excess loss.

**It is recommended** that the Company's claim files maintain the reserve change form to support the reserve adjustment.

### **Policyholder Complaints – Page 17**

**It is recommended** that the Company's complaint register consist of all written grievances, from both complaints made directly to the Company and complaints filed with the appropriate Department of Insurance, in order to be in accordance with the NAIC Market Conduct Examiner's Handbook.

### **Agents' Licensing Requirements – Page 17**

**It is recommended** that the Company be able to provide the Notice of Cancellation for all producers that are terminated.

### **Reinsurance – Page 17**

**It is recommended** that the Company maintain appropriate levels of managerial experience when entering into transactions relating to, but not limited to, reinsurance assumed transactions with the foreign and/or alien insurance market.

**It is recommended** that the Company periodically audit the ceding companies to determine whether the accounting data is being provided in accordance with the contract provisions.

**It is recommended** that the Company maintain complete copies of its reinsurance agreements in its office and make such agreements readily available for review.

### **Accounts and Records – Page 19**

**It is recommended** that the Disaster Recovery Plan be tested completely and to have the written results on file.

**It is recommended** that the Company prepare and implement a records retention program in accordance with IRS Revenue Procedure 1998.

**It is recommended** that the Company prepare written procedural manuals for all departments.

**It is recommended** that the Company maintain documentation of the management's responses to the recommendations of the internal audit reports.

### **Bonds – Page 25**

**It is recommended** that the Company value securities in accordance with the standards of the NAIC Securities Valuation Office as required by Alabama Department of Insurance Regulation Number 98 and the NAIC Annual Statement Instructions.

**It is recommended** that the Company submit all securities with a "Z" designation to the Securities Valuation Office for valuation within 120 days of the date the security is acquired as required by the Purposes and Procedures Manual of the NAIC Securities Valuation Office.

**It is recommended** that the Company use the proper CUSIP number when preparing Schedule D as set forth in the NAIC Annual Statement Instructions.

**It is recommended** that the Company include the proper “PE” designations when reporting provisionally exempt securities on Schedule D - Part 1 as required by the Purposes and Procedures Manual of the NAIC Securities Valuation Office.

**It is recommended** that the Company obtain fair values from independent sources as required by the NAIC when completing Schedule DM.

#### **Common stocks – Page 26**

**It is recommended** that the Company report SCA Investments to the NAIC Securities Valuation Office by filing a SUB 1-form filing within thirty days of acquisition and filing a SUB 2-form by June in each of the following years.

**It is recommended** that the Company refer to the Treasury Stock and Reciprocal Ownership Elimination Worksheet of the NAIC Securities Valuation Office when valuing stock in its ultimate parent, ProAssurance Corporation.

#### **Cash and short-term investments – Page 26**

**It is recommended** that the Company comply with ALA. CODE §27-37-3 (1975), ALA. CODE §27-37-4(b)(2) (1975) and SSAP No. 4 when evaluating the characteristics of an asset and determining if it should be admitted.

**It is recommended** that the Company include a complete and accurate description of securities on Schedule DA - Part 1 as required by the Purposes and Procedures Manual of the NAIC Securities Valuation Office.

**It is recommended** that the Company enter a CUSIP number that conforms to those as provided and published by the Securities Valuation Office in accordance with the NAIC Annual Statement Instructions when preparing Schedule DA - Part 1.

**It is recommended** that the Company receive as collateral transferred securities having a fair value at least equal to 102 percent of the purchase price paid as required by SSAP No. 45.

#### **Premiums and agents’ balances in course of collection – Page 27**

**It is recommended** that the Company comply with the NAIC Annual Statement Instructions, by including “Receivable amounts due” when calculating Premiums and agents’ balances in course of collection.

**It is recommended** that the Company comply with the NAIC Annual Statement Instructions, which state “Corrections of errors in previously issued financial statements...should be reported on the Aggregate write-ins for gains and losses in surplus line.”

**It is recommended** that the Company calculate the agents’ balances or uncollected premiums on a policy basis rather than using an estimate to determine what should be reported under Premiums and agent’s balances in course of collection.

**Premiums, agents’ balances and installments booked but deferred and not yet due – Page 28**

**It is recommended** that the Company comply with the NAIC Annual Statement Instructions, by including “Receivable amounts not yet due” when calculating Premiums, agents’ balances and installments booked but deferred and not yet due.

**It is recommended** that the Company calculate the agents’ balances or uncollected premiums on a policy basis rather than using an estimate to determine what should be reported under Premiums, agent’s balances and installments booked but deferred and not yet due.

**Reinsurance recoverable – Page 28**

**It is recommended** that the Company comply with the NAIC Annual Statement Instructions, which by including losses and loss adjustment expenses that will be recovered from the ceding companies.

**It is recommended** that the Company comply with the NAIC Annual Statement Instructions, which require that Notes to the Financial Statements, under Number 22, Section D, Uncollectible Reinsurance describe uncollectible reinsurance written off during the year. SSAP No. 62, paragraph 67 also requires disclosure of uncollectible reinsurance.

**Receivable from parent, subsidiaries and affiliates – Page 29**

**It is recommended** that the Company not establish receivables with affiliates which are not supported by an agreement.

**It is recommended** that the Company comply with the NAIC Annual Statement Instructions, which state to include only unsecured current accounts receivable from parent, subsidiaries and affiliates.

**It is recommended** that the Company not net payables and receivables from unrelated entities in accordance with the NAIC Annual Statement Instructions and SSAP No. 64.

**Commissions payable, contingent commissions and other similar charges – Page 30**

**It is recommended** that the Company pay the commission rates listed in the commission agreements or amend its commission agreements to reflect the correct commission rates.

### **Other expenses – Page 31**

**It is recommended** that the Company include Unclaimed Property in Amounts withheld or retained by company for account of others as required by the NAIC Annual Statement Instructions.

### **Amounts withheld or retained by company for account of others – Page 31**

**It is recommended** that the Company comply with ALA. CODE §35-12-27 (1975), which requires the Company to deposit with the State Treasurer funds that are unclaimed for over five years.

**It is recommended** that the Company include Unclaimed Property in Amounts withheld or retained by company for account of others as required by the NAIC Annual Statement Instructions.

### **Provision for reinsurance – Page 31**

**It is recommended** that the Company comply with the Alabama Department of Insurance Regulation Number 105 and ALA. CODE §27-5-12(iv)4 (1975), which requires that the trustee of a trust agreement be a qualified U.S. financial institution.

**It is recommended** that the Company comply with the NAIC Annual Statement Instructions and report trust funds and other acceptable securities under column 10, Other Allowed Offset Items.

**It is recommended** that the Company comply with the NAIC Annual Statement Instructions and include all unauthorized reinsurers on Schedule F - Part 5.

**It is recommended** that the Company comply with the NAIC Annual Statement Instructions when completing Schedule F - Part 6. Reinsurance recoverables in dispute should be excluded from Columns 4 and 5 and included in Column 9.

**It is recommended** that the Company write off uncollectible reinsurance recoverables in accordance with SSAP No. 62, paragraph 56 and write off the uncollectible reinsurance balance through the accounts, exhibits and schedules in which they were originally recorded.

### **Payable to parent, subsidiaries and affiliates – Page 33**

**It is recommended** that the Company not have business transactions with affiliates that are not supported by an agreement.

**It is recommended** that the Company report payables and receivables from different entities separately in accordance with the NAIC Annual Statement Instructions and SSAP No. 64.

**Premium deficiency reserve – Page 33**

**It is recommended** that the Company implement a formal procedure to evaluate the possible requirement of a premium deficiency reserve.

**Common capital stock – Page 33**

**It is recommended** that the Company correct the transfer error of \$125,808 between paid in and contributed surplus, and common capital stocks.

**It is recommended** that the Company reconcile the stock outstanding to the general ledger.

**Subsequent Events – Page 35**

**It is recommended** that the Company comply with ALA. CODE §27-41-5 (1975) submit regular reports of investments to the Board of Directors.

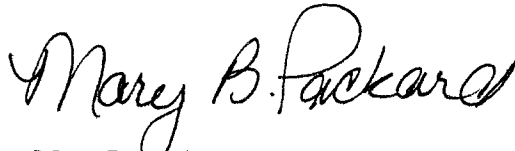
## CONCLUSION

Acknowledgement is hereby made of the courteous cooperation extended by the officers and employees of the Company during the course of this examination.

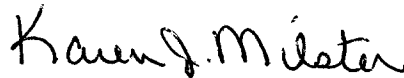
The customary insurance examination procedures, as recommended by the National Association of Insurance Commissioners, have been followed to the extent appropriate in connection with the verification and valuation of assets and determination of liabilities set forth in this report.

In addition to the undersigned, Joy Griggs, Jeff Hawkins, Jayne Simms and Lori Wright, Examiners; and R. Glenn Taylor, ACAS, MAAA, Consulting Actuary, all representing the Alabama Department of Insurance, participated in this examination of The Medical Assurance Company, Inc.

Respectfully submitted,



Mary B. Packard, CFE, CPA  
Examiner-in-Charge  
Department of Insurance  
State of Alabama  
Southeastern Zone, NAIC



Karen Milster, CFE, CPA  
Zone Examiner  
Department of Insurance  
State of Missouri  
Midwestern Zone, NAIC

MEMORANDUM

TO: Richard Ford, Chief Examiner

FROM: Mary B. Packard, CPA, CFE

SUBJECT COMPANY: Red Mountain Casualty Insurance Company, Inc.

Per your instructions, examination of the above captioned company has been completed. The following information is submitted herewith.

Date Started: February 3, 2003

Date Completed: August 22, 2003

As of December 31, 1996

<u>Examiners Participating</u>	<u>State</u>	<u>Working Days</u>
<u>Mary B. Packard, CPA, CFE</u>	<u>Alabama</u>	<u>39.0000</u>
<u>Jeffrey A. Hawkins</u>	<u>Alabama</u>	<u>7.8750</u>
<u>Jayne Simms</u>	<u>Alabama</u>	<u>3.1250</u>
<u>Lori Wright</u>	<u>Alabama</u>	<u>24.0000</u>
		<u>74.0000</u>

Actuary R. Glenn Taylor, ACAS, MAAA

Should S.I.S. Form be filed? (If 100 or more stockholders)?

NO

Should Proxy Material be filed?

NO

Have all Form B Holding Company filings been completed?

YES

Officers

President: Victor Thomas Adamo

Controller (or person having control of Company books): James Joseph Morello

Claims Managers: Robert David Francis

Proper Mailing Address: 100 Brookwood Place  
Birmingham, AL 35209

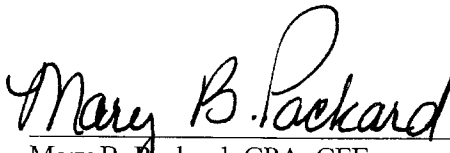
Telephone Number: 205-877-4400

Condition of the Company at 12/31/02

Assets: \$ 17,951,539

Liabilities: \$ 2,122,134

Surplus: \$ 15,829,405

  
Mary B. Packard, CPA, CFE  
Examiner-in-charge

Date: August 22, 2003





DON SIEGELMAN  
GOVERNOR

STATE OF ALABAMA  
DEPARTMENT OF INSURANCE  
201 MONROE STREET, SUITE 1700  
POST OFFICE BOX 303351  
MONTGOMERY, ALABAMA 36130-3351

TELEPHONE: (334) 269-3550  
FACSIMILE: (334) 241-4192  
INTERNET: [www.aldoi.org](http://www.aldoi.org)

D. DAVID PARSONS  
COMMISSIONER  
ASSISTANT COMMISSIONER  
TREY GRANGER  
DEPUTY COMMISSIONER  
JAMES R. (JOHNNY) JOHNSON  
CHIEF EXAMINER  
RICHARD L. FORD  
STATE FIRE MARSHAL  
JOHN S. ROBISON  
GENERAL COUNSEL  
MICHAEL A. BOWNES  
RECEIVER  
DENISE B. AZAR  
LICENSING MANAGER  
JIMMY W. GUNN

December 18, 2002

Mr. Glen Taylor  
Taylor-Walker & Associates, Inc.  
Actuarial Consulting Group  
P. O. Box 156  
40 North Main  
Midvale, UT 84047

Re: Examination of Medical Assurance Company, Inc.  
As of December 31, 2002

Dear Mr. Taylor:

This letter is to request and authorize your participation in the examination of the above referenced company for the purpose of computing reserves and making other valuations in your usual manner.

The examination will begin on or about January 27, 2003. The examination for this company is being conducted in the company's offices at 100 Brookwood Place, Suite 500, Birmingham, AL 35209, and will cover the period ending December 31, 2002. The expected duration of the examination is approximately six months.

The Examiner-in-Charge will be Ms. Mary Packard. Please contact her at the company after the beginning date to coordinate the scheduling of your portion of this examination. The company telephone number is (205) 877-4400.

If your schedule does not permit you to accept this assignment, please let me know so that other arrangements can be made.

Thank you for your assistance in this matter.

Sincerely,

Richard L. Ford, CFE  
Acting Deputy Commissioner and  
Chief Examiner

RLF:dk

cc: Jack M. Brown, CFE, CIE  
Mary Packard, CFE, Examiner-in-Charge  
Glenda Daniel, Analyst

**SENDER: COMPLETE THIS SECTION**

- Complete items 1, 2, and 3. Also complete item 4 if Restricted Delivery is desired.
- Print your name and address on the reverse so that we can return the card to you.
- Attach this card to the back of the mailpiece, or on the front if space permits.

1. Article Addressed to:

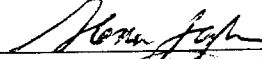
Mr. Glen Taylor  
Taylor-Walker & Associates Inc.  
Actuarial Consulting Group  
P O Box 156  
40 North Main  
Midvale UT 84047

**COMPLETE THIS SECTION ON DELIVERY**

A. Received by (Please Print Clearly)

B. Date of Delivery

C. Signature

**X**☐ Agent☐ Addressee

D. Is delivery address different from item 1?

If YES, enter delivery address below:

☐ Yes☐ No

3. Service Type

☒ Certified Mail☐ Express Mail☐ Registered☒ Return Receipt for Merchandise☐ Insured Mail☐ C.O.D.

4. Restricted Delivery? (Extra Fee)

☐ Yes

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PS Form 3811, July 1999

Domestic Return Receipt

102595-00-M-0952



DON SIEGELMAN  
GOVERNOR

STATE OF ALABAMA  
DEPARTMENT OF INSURANCE  
201 MONROE STREET, SUITE 1700  
POST OFFICE BOX 303351  
MONTGOMERY, ALABAMA 36130-3351  
TELEPHONE: (334) 269-3550  
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D. DAVID PARSONS  
COMMISSIONER  
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JOHN S. ROBISON  
GENERAL COUNSEL  
MICHAEL A. BOWNES  
RECEIVER  
DENISE B. AZAR  
LICENSING MANAGER  
JIMMY W. GUNN

December 18, 2002

Mr. Aubrey Derrill Crowe  
President  
Medical Assurance Company, Inc.  
100 Brookwood Place, Suite 500  
Birmingham, AL 35209

**Re: Financial/Market Conduct Examination As Of December 31, 2002**

Dear Mr. Crowe:

This letter is to inform you of a financial/market conduct examination of your company called by the Alabama Department of Insurance and to authorize Mary Packard, CFE, Examiner, to conduct the examination. This authorization is pursuant to the instructions of Alabama Insurance Commissioner, D. David Parsons, and in compliance with the statutory requirements of the State of Alabama and resolutions adopted by the National Association of Insurance Commissioners. The NAIC has required as an accreditation standard that examination reports be issued within eighteen (18) months of the "as of" date of the examination. This is requiring us to begin the examinations earlier to meet this requirement.

Your examination is to commence on or about January 27, 2003, and will be conducted primarily in your offices. The expected duration of the examination is approximately six months. Preliminary planning of your examination will first begin in the offices of the Alabama Department of Insurance. The examiner will arrive in your offices on or after this date. You will be contacted by Ms. Packard regarding the exact arrival date at your offices.

The Alabama Insurance Department has adopted work policies and rules governing work hours, leave and unacceptable conduct including sexual harassment. If you have any question about our examiner's conduct at your offices, please contact me immediately.

Mr. Aubrey Derrill Crowe  
Page 2  
December 17, 2002

As part of your examination, the enclosed internal control and information systems questionnaire is required to be completed for review by our examiner. Please complete and return the questionnaire to this Department within 30 days, addressed to the attention of the Examiners' Division. The questions may be answered on the questionnaire itself or on a separate sheet if additional explanation is required. If possible, your CPA's workpapers and a representative of your CPA firm should be available the week of January 27, 2003, for review at your offices.

Invoices covering examination fees and related expenses will be submitted to the appropriate company official in accordance with standard Departmental policy. Payment of any examination charges so invoiced are due within two business days following presentation of the invoice.

Sincerely,

A handwritten signature in black ink, appearing to read "Richard L. Ford".

Richard L. Ford, CFE, CIE  
Acting Deputy Commissioner and  
Chief Examiner

RLF:dk

Enclosures

cc: Jack M. Brown, CFE, CIE  
Mary Packard, CFE, Examiner-in-Charge  
Glenda Daniel, Analyst

**SENDER: COMPLETE THIS SECTION**

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- Print your name and address on the reverse so that we can return the card to you.
- Attach this card to the back of the mailpiece, or on the front if space permits.

## 1. Article Addressed to:

Mr. Aubrey Derrill Crowe  
President  
Medical Assurance Company Inc  
100 Brookwood Place Suite 500  
Birmingham, AL 35209

**COMPLETE THIS SECTION ON DELIVERY**

A. Received by (Please Print Clearly)

Leslie McLaughlin

B. Date of Delivery

12-23-0

C. Signature

x Leslie McLaughlin

☐ Agent☐ Addressee

D. Is delivery address different from item 1?

☐ Yes

If YES, enter delivery address below:

☐ No

## 3. Service Type

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## 4. Restricted Delivery? (Extra Fee)

☐ Yes

## 2. Article Number (Copy from service label)

7000 1670 0006 3511 9787

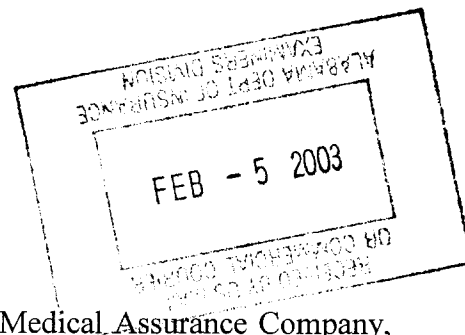
PS Form 3811, July 1999

Domestic Return Receipt

102595-00-M-0952

January 28, 2003

Mary B. Packard  
Alabama Insurance Department  
P.O. Box 303351  
Montgomery, AL 36130-3351



Dear Madam:

In connection with the regulatory examination of the The Medical Assurance Company, Inc. ("Company") by the Alabama Insurance Department, the Department has requested that we allow it access to our working papers prepared in connection with our audit of the 2001, 2000, 1999 and 1998 statutory-basis financial statements of the Company.

In connection with the issuance of our auditors' report on the Company's 2001, 2000, 1999 and 1998 statutory-basis financial statements, we issued a qualifications letter dated February 22, 2002, February 14, 2001, February 11, 2000 and February 8, 1999, respectively, to the Company, which the Company filed with the Department. Our audit was conducted with the objectives, and subject to the limitations, stated in that letter. That letter indicates, among other things, that we would make our working papers available to the Department. We have not audited any financial statements of the Company since December 31, 2001, nor have we performed any audit procedures since February 22, 2002, the date of our auditors' report, and significant events or circumstances may have occurred since that date. In addition, any notations, comments, and individual conclusions appearing on any of the audit working papers do not stand alone, and should not be read as an opinion on any individual amounts, accounts, balances or transactions.

Our working papers constitute and reflect work performed or information obtained by Ernst & Young LLP in its capacity as independent auditors for the Company. The documents contain trade secrets and confidential commercial and financial information of our firm and the Company that is privileged and confidential, and we expressly reserve all rights with respect to disclosures to third parties who are not directly involved in the examination of the statutory-basis financial statements as of December 31, 2001, 2000, 1999 and 1998, and for the years then ended. Accordingly, we request confidential treatment under the Freedom of Information Act or similar laws and regulations, to the extent that laws or regulations do not preclude such treatment, when requests are made for the working papers or information contained in them or any documents created by the Department or those acting on its behalf containing information derived from them. We further request that written notice be given to our firm before distribution of the information in the working papers (or photocopies of them) to others, including other governmental agencies, except when such distribution is required by law or regulation.



BOB RILEY  
GOVERNOR

STATE OF ALABAMA  
DEPARTMENT OF INSURANCE  
201 MONROE STREET, SUITE 1700  
POST OFFICE BOX 303351  
MONTGOMERY, ALABAMA 36130-3351  
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WALTER A. BELL  
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ASSISTANT COMMISSIONER  
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JAMES R. (JOHNNY) JOHNSON  
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JOHN S. ROBISON  
GENERAL COUNSEL  
MICHAEL A. BOWNES  
RECEIVER  
DENISE B. AZAR  
LICENSING MANAGER  
JIMMY W. GUNN

February 6, 2003

Douglas W. Johnson  
Ernst & Young LLP  
AmSouth/Harbert Plaza  
Suite 1900  
1901 Sixth Avenue North  
Birmingham, AL 35203

Re: Request for CPA Workpapers in December 31, 2002 Examination of The Medical Assurance Company, Inc.

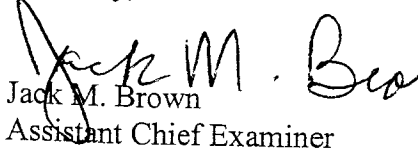
Dear Sir:

We received your January 28, 2003, letter regarding the request for inspection of the workpapers prepared in the referenced examination.

The request to inspect the workpapers is made by your client pursuant to Section 13 of Regulation 100. The letter of qualification your firm provided your insurer client should consent and agree to make available for review by the Commissioner, his designee or his appointed agent, the workpapers prepared in your examination. This agreement and consent is required by Section 12 of Regulation 100. Any copies of your firm's workpapers included in the Department's files will remain confidential to the extent provided under Alabama law.

If you have any questions, please advise.

Sincerely,

  
Jack M. Brown  
Assistant Chief Examiner

cc: Richard Ford  
Mary Packard, Examiner-in-Charge

August 7, 2003

Mary B. Packard, CFE  
Examiner-In-Charge  
Alabama Department of Insurance  
P.O. Box 303351  
Montgomery, AL 36130-3351

We are providing this letter in connection with your examination of the statutory financial statements of The Medical Assurance Company, Inc. as of December 31, 2002. We are responsible for the preparation of the statutory financial statements of financial position, results of operations, and changes in statutory financial position in conformity with the accounting practices prescribed or permitted by the Alabama Department of Insurance.

Certain representations in this letter are described as being limited to those matters that are material. Solely for the purpose of preparing this letter, the term "material", when used in this letter, means any item or group of similar items involving potential amounts of more than \$4,000,000. These amounts are not intended to represent the materiality threshold for financial reporting and disclosure purposes. Notwithstanding this, an item is considered material, regardless of size, if it involves an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it possible that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, the following representations made to you during the examination.

We have made available to you all:

- Statutory financial records and related data; and
- Minutes of meetings of stockholders, directors and committees, or summaries of actions of recent meetings for which minutes have not yet been prepared.

There have been no:

- Fraud or other irregularities involving management or employees who have significant roles in the internal control structure;
- Fraud or other irregularities involving other employees that have or may have a material effect on the statutory financial statements;
- Fraud or other irregularities involving agents, MGA's, third party administrators, independent contractors, holding companies or other individuals or parties that have or may have a material impact on the statutory financial position of the Company; or



- Communication from regulatory agencies concerning noncompliance with, or deficiencies in, statutory financial reporting practices.

We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.

The financial statements are free of material and intentional immaterial misstatements.

The following have been properly recorded or disclosed in the statutory financial statements:

- Any related party transactions and related amounts receivable or payable, including sales, purchases, loans, transfers, leasing arrangements, and guarantees, except as discussed in the Report of Examination.
- All liabilities, both actual and contingent, except as discussed in the Report of Examination.
- Guarantees whether written or oral, under which the Company is contingently liable.
- Capital stock repurchase options or agreements on capital stock reserved for options, warrants, conversions, or requirements.
- Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances and line-of-credit or similar arrangements.
- Significant estimates and material concentrations known to management that are required to be disclosed in accordance with SSAP No. 1, *Disclosure of Accounting Policies, Risk and Uncertainties, or Other Disclosures*.
- Amount of credit risk and extent, nature, and terms of financial instruments with off-balance-sheet risk in accordance with SSAP No. 27.
- Agreements to repurchase assets previously sold.

We confirm the completeness of the information provided regarding the identification of related parties.

There are no violations or possible violations of laws or regulations whose effects should be considered for disclosure in the statutory financial statements or as a basis for recording a loss contingency.

Contingent Liabilities:

- There are no other liabilities or gain or loss contingencies that are required to be accrued or disclosed by SSAP No. 5.
- There is no litigation against the Company that is considered material in relation to the statutory financial position of the Company. For purposes of this section, the Company has excluded litigation for which the only amounts sought relate to benefits within the normal terms of coverage under contracts of insurance issued by the Company, and which are otherwise considered in the actuarial determination of the Company's unpaid claim reserves.

Adequate provision has been made for adjustments and losses in collection of receivables.

Provision has been made for estimated retroactive adjustments by third-party payors under reimbursement agreements.

The Company is in compliance with bond indentures or other debt instruments.

Pending changes in the organizational structure, financing arrangements, or other matters that could have a material effect on the financial statements of the Company are properly disclosed.

The Company has properly classified all assets as admitted or nonadmitted in accordance with SSAP No. 4.

The Company has free and clear title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged except as disclosed in the annual statement.

We have reviewed long-lived assets and certain identifiable intangibles whenever changes in circumstances have indicated that the carrying amount of these assets might not be recoverable and have recorded the adjustment in accordance with SSAP No. 5.

Deferred tax assets and liabilities as reported in the financial statements comply and have been valued in accordance with SSAP No. 10, *Income Taxes*.

The Company has properly disclosed and recorded any premium deficiency reserves in accordance with SSAP No. 53.

Investments are appropriately recorded and valued as follows:

- Bonds – are recorded and disclosed in accordance with SSAP No. 26 and interpretation thereof, except as discussed in the Examination Report.
- Preferred stocks – are recorded and disclosed in accordance with SSAP No. 32 and interpretations thereof.
- Common stocks – are recorded and disclosed in accordance with SSAP No. 30 and interpretations thereof. Common stock of subsidiaries and affiliated or controlled companies are recorded and disclosed in accordance with SSAP No. 46 and interpretations thereof, except as discussed in the Examination Report.
- Short-term investments – are recorded and disclosed in accordance with SSAP No. 2 and interpretations thereof, except as discussed in the Examination Report.
- Real estate – are recorded and disclosed in accordance with SSAP No. 40 and interpretations thereof.

The Company's liabilities for unpaid losses and loss adjustment expenses are based on and recorded at management's best estimate in accordance with SSAP No. 55.

Agents' balances or uncollected premiums have been recorded and disclosed in accordance with SSAP 6, except as discussed in the Report of Examination.

There were no material commitments for construction or acquisition of property, plant and equipment, or to acquire other noncurrent assets, such as investments or intangibles.

We have complied with all aspects of contractual agreements that would have a material effect on the statutory financial statement in the event of noncompliance.

There are no material transactions that have not been properly recorded in the accounting records underlying the statutory financial statements.

All required returns and statutory reporting requirements have been filed on a timely basis with the appropriate regulatory bodies.

All material reinsurance transactions have been recorded and disclosed in accordance with SSAP No. 62.

The Company has properly disclosed and recorded all changes in accounting principles in accordance with SSAP No. 3.

The Company has recorded and disclosed subsequent events in accordance with SSAP No. 9.

The Company is aware of the employment of or a business relationship with a "prohibited person" as defined in The Violent Crime Control and Law Enforcement Act of 1994: United States Code, Section 1033 (e)(1)(A). However, the Company had obtained a temporary waiver for the employee and is seeking a permanent waiver at the time this letter was signed.

We agree with the findings of specialists in evaluating the Loss and LAE Reserves and have adequately considered the qualifications of the specialists in determining the amounts and disclosures used in the financial statements and underlying accounting records. We did not give or cause any instructions to be given to the specialists with respect to the values or amounts derived in an attempt to bias their work.

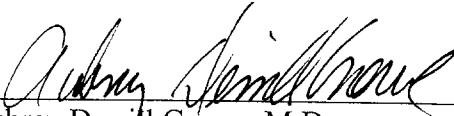
The Company has recorded and disclosed benefit plans and defined contribution plans in accordance with SSAP No. 8.

The Company has recorded and disclosed postretirement benefits other than pensions in accordance with SSAP No. 14.

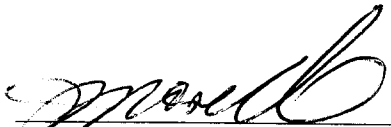
We understand that your examination was made in accordance with standards established by the Alabama Department of Insurance, and procedures established by *the National Association of Insurance Commissioners*, and accordingly included such tests of the

accounting records and such other procedures as considered necessary under the circumstances.

The Medical Assurance Company, Inc.

  
\_\_\_\_\_  
Aubrey Derrill Crowe, M.D.  
Chief Executive Officer

8/7/03  
Date

  
\_\_\_\_\_  
James Joseph Morello, C.P.A.  
Chief Financial Officer

8/7/03  
Date



BOB RILEY  
GOVERNOR

STATE OF ALABAMA  
DEPARTMENT OF INSURANCE  
201 MONROE STREET, SUITE 1700  
POST OFFICE BOX 303351  
MONTGOMERY, ALABAMA 36130-3351  
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WALTER A. BELL  
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GENERAL COUNSEL  
MICHAEL A. BOWNES  
RECEIVER  
DENISE B. AZAR  
PRODUCER LICENSING MANAGER  
JIMMY W. GUNN

August 26, 2003

**CERTIFIED MAIL**  
**RETURN RECEIPT REQUESTED**

Mr. Aubrey Derrill Crowe  
President  
Medical Assurance Company, Inc.  
100 Brookwood Place, Suite 500  
Birmingham, AL 35209

**RE: The Medical Assurance Company, Inc.  
Report of Examination as of December 31, 2002**

Dear Mr. Crowe:

Enclosed is a copy of the Report of Examination of the above-cited company as of December 31, 2002. In the event that you have any objections to this report, please advise this Department in writing within twenty (20) days, and a hearing will be scheduled, at which time you may present your arguments regarding any objections.

Unless we hear from you within the above-stated time, the report will be filed as a public document. Once filed, no annual or quarterly statements, or other material reflecting the statutory financial condition of the company may be filed with or accepted by this Department if those statements conflict with any basis of calculation to establish the value of any asset, liability, or capital account in the report.

Sincerely,

Richard L. Ford, CFE, CIE  
Chief Examiner

RLF:dk

Enclosure

cc: Jack M. Brown, CFE, CIE  
Mary Packard, CFE  
Glenda Daniel

**SENDER: COMPLETE THIS SECTION**

- Complete items 1, 2, and 3. Also complete item 4 if Restricted Delivery is desired.
- Print your name and address on the reverse so that we can return the card to you.
- Attach this card to the back of the mailpiece, or on the front if space permits.

1. Article Addressed to:

**Mr. Aubrey Derrill Crowe**  
**President**  
**Medical Assurance Company Inc.**  
**100 Brookwood Place Suite 500**  
**Birmingham, AL 35209**

2. Article Number (Copy from service label)

7002 2030 0000 9484 0676

PS Form 3811, July 1999

Domestic Return Receipt

**COMPLETE THIS SECTION ON DELIVERY**

A. Received by (Please Print Clearly) B. Date of Delivery

Kevin Massey

C. Signature

X Kevin Massey

☐ Agent☐ AddresseeD. Is delivery address different from item 1? ☐ YesIf YES, enter delivery address below: ☐ No

3. Service Type

☒ Certified Mail☐ Express Mail☐ Registered☒ Return Receipt for Merchandise☐ Insured Mail☐ C.O.D.

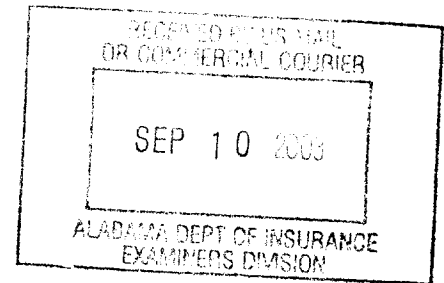
4. Restricted Delivery? (Extra Fee)

☐ Yes

102595-00-M-0952

September 9, 2003

Mr. Richard Ford, Chief Examiner  
State of Alabama  
Department of Insurance  
201 Monroe Street, Suite 1700  
P O Box 303351  
Montgomery, Alabama 36130-3351



RE: The Medical Assurance Company, Inc.  
Report of Examination as of December 31, 2002


Dear Mr. Ford:

Thank you for your letter of August 26, 2003 containing the above mentioned report.

Please be advised that The Medical Assurance Company, Inc. will not be requesting a hearing in conjunction with the Report of Examination as of December 31, 2002.

Thank you for the Department's efforts in conjunction with this report.

Sincerely,

  
A. Derrill Crowe, M.D.  
President

ADC/kn

cc: Jack M. Brown, CFE, CIE  
Mary Packard, CFE  
Glenda Daniel



BOB RILEY  
GOVERNOR

STATE OF ALABAMA  
DEPARTMENT OF INSURANCE  
201 MONROE STREET, SUITE 1700  
POST OFFICE BOX 303351  
MONTGOMERY, ALABAMA 36130-3351  
TELEPHONE: (334) 269-3550  
FACSIMILE: (334) 241-4192  
INTERNET: [www.aldoi.org](http://www.aldoi.org)

WALTER A. BELL  
COMMISSIONER  
DEPUTY COMMISSIONER  
D. DAVID PARSONS  
JAMES R. (JOHNNY) JOHNSON  
CHIEF EXAMINER  
RICHARD L. FORD  
STATE FIRE MARSHAL  
JOHN S. ROBISON  
GENERAL COUNSEL  
MICHAEL A. BOWNES  
RECEIVER  
DENISE B. AZAR  
PRODUCER LICENSING MANAGER  
JIMMY W. GUNN

BEFORE THE INSURANCE COMMISSIONER  
OF THE  
STATE OF ALABAMA

IN THE MATTER OF: )  
FINANCIAL CONDITION EXAMINATION OF )  
THE MEDICAL ASSURANCE COMPANY INC )  
AS OF DECEMBER 31, 2002 )

ORDER

ON THE 25th day of September, 2003, the above entitled cause came on for consideration by the Insurance Commissioner, pursuant to Regulation 103. The Insurance Commissioner, having fully considered and reviewed the Examination Report together with any written submissions or written rebuttals and any relevant portions of the examiners' workpapers, finds and states as follows, to-wit:

JURISDICTION

1. That the Insurance Commissioner has jurisdiction of this cause, pursuant to the provisions of the Alabama Insurance Code.
2. That The Medical Assurance Company, Inc. is a domestic insurer licensed for property, miscellaneous casualty, including official surety bonds, and disability in the State of Alabama.



**FINDINGS OF FACT**

1. That on August 22, 2003, the verified Financial Condition Examination Report of The Medical Assurance Company, Inc. was filed with the Insurance Department.
2. That following receipt of the December 31, 2002 Examination Report, the Company was afforded a reasonable opportunity of not more than twenty (20) days to make a written submission or written rebuttal with respect to any matters contained in the Examination Report.
3. That Regulation 103 provides that within twenty (20) days of the end of the period allowed for the receipt of written submissions or written rebuttals, the Insurance Commissioner shall fully consider and review the report, together with any written submissions or written rebuttals and any relevant portions of the examiners' workpapers and enter an order. The order shall either: (i) adopt the examination report as filed or with modifications or corrections, including an order that the company take actions to cure any violations; (ii) reject the examination report with directions to the examiners to reopen the examination for purposes of obtaining additional data, documentation or information; or (iii) call for an investigatory hearing for purposes of obtaining additional documentation, data, information and testimony.
4. Regulation 103 requires the company to file affidavits executed by each of its directors stating under oath that they have received a copy of the adopted report and related orders within thirty (30) days of the issuance of the adopted report.

**CONCLUSIONS OF LAW**

1. That the December 31, 2002 Financial Condition Examination Report of The Medical Assurance Company, Inc. shall be and hereby is Adopted by the Insurance Commissioner, pursuant to Regulation 103.

CERTIFICATION

I, \_\_\_\_\_, \_\_\_\_\_ (office) of  
\_\_\_\_\_ Company, do hereby certify that the Report of Examination of  
\_\_\_\_\_ Company as of \_\_\_\_\_, \_\_\_\_\_, was filed with all states in  
which \_\_\_\_\_ Company is licensed, and with the office of the National Association of  
Insurance Commissioners.

By: \_\_\_\_\_

Sworn and subscribed before the undersigned authority on the \_\_\_\_ day of \_\_\_\_\_, 2003.

Seal

\_\_\_\_\_  
Notary

## SENDER: COMPLETE THIS SECTION

- Complete items 1, 2, and 3. Also complete item 4 if Restricted Delivery is desired.
- Print your name and address on the reverse so that we can return the card to you.
- Attach this card to the back of the mailpiece, or on the front if space permits.

## 1. Article Addressed to:

Aubrey Derrill Crowe  
President  
The Medical Assurance Company Inc.  
100 Brookwood Place, Suite 500  
Birmingham, AL 35209

## 2. Article Number (Conv from service label)

7002 2030 0000 9484 0775

PS Form 3811, July 1999

Domestic Return Receipt

## COMPLETE THIS SECTION ON DELIVERY

A. Received by (Please Print Clearly)

B. Date of Delivery

C. Signature

X

FRANK MASSEY

☐ Agent

☐ Addressee

D. Is delivery address different from item 1?

☐ Yes

If YES, enter delivery address below:

☐ No

## 3. Service Type

☒ Certified Mail

☐ Express Mail

☐ Registered

☒ Return Receipt for Merchandise

☐ Insured Mail

☐ C.O.D.

## 4. Restricted Delivery? (Extra Fee)

☐ Yes

102595-00-M-0952



DON SIEGELMAN  
GOVERNOR

STATE OF ALABAMA  
DEPARTMENT OF INSURANCE  
201 MONROE STREET, SUITE 1700  
POST OFFICE BOX 303351  
MONTGOMERY, ALABAMA 36130-3351  
TELEPHONE: (334) 269-3550  
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D. DAVID PARSONS  
COMMISSIONER  
ASSISTANT COMMISSIONER  
TREY GRANGER  
DEPUTY COMMISSIONER  
JAMES R. (JOHNNY) JOHNSON  
CHIEF EXAMINER  
RICHARD L. FORD  
STATE FIRE MARSHAL  
JOHN S. ROBISON  
GENERAL COUNSEL  
MICHAEL A. BOWNES  
RECEIVER  
DENISE B. AZAR  
LICENSING MANAGER  
JIMMY W. GUNN

December 18, 2002

Mr. Aubrey Derrill Crowe  
President  
Medical Assurance Company, Inc.  
100 Brookwood Place, Suite 500  
Birmingham, AL 35209

Re: Financial/Market Conduct Examination As Of December 31, 2002

Dear Mr. Crowe:

This letter is to inform you of a financial/market conduct examination of your company called by the Alabama Department of Insurance and to authorize Mary Packard, CFE, Examiner, to conduct the examination. This authorization is pursuant to the instructions of Alabama Insurance Commissioner, D. David Parsons, and in compliance with the statutory requirements of the State of Alabama and resolutions adopted by the National Association of Insurance Commissioners. The NAIC has required as an accreditation standard that examination reports be issued within eighteen (18) months of the "as of" date of the examination. This is requiring us to begin the examinations earlier to meet this requirement.

Your examination is to commence on or about January 27, 2003, and will be conducted primarily in your offices. The expected duration of the examination is approximately six months. Preliminary planning of your examination will first begin in the offices of the Alabama Department of Insurance. The examiner will arrive in your offices on or after this date. You will be contacted by Ms. Packard regarding the exact arrival date at your offices.

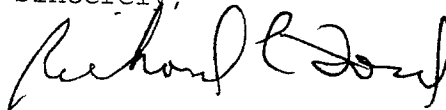
The Alabama Insurance Department has adopted work policies and rules governing work hours, leave and unacceptable conduct including sexual harassment. If you have any question about our examiner's conduct at your offices, please contact me immediately.

Mr. Aubrey Derrill Crowe  
Page 2  
December 17, 2002

As part of your examination, the enclosed internal control and information systems questionnaire is required to be completed for review by our examiner. Please complete and return the questionnaire to this Department within 30 days, addressed to the attention of the Examiners' Division. The questions may be answered on the questionnaire itself or on a separate sheet if additional explanation is required. If possible, your CPA's workpapers and a representative of your CPA firm should be available the week of January 27, 2003, for review at your offices.

Invoices covering examination fees and related expenses will be submitted to the appropriate company official in accordance with standard Departmental policy. Payment of any examination charges so invoiced are due within two business days following presentation of the invoice.

Sincerely,



Richard L. Ford, CFE, CIE  
Acting Deputy Commissioner and  
Chief Examiner

RLF:dk

Enclosures

cc: Jack M. Brown, CFE, CIE  
Mary Packard, CFE, Examiner-in-Charge  
Glenda Daniel, Analyst

**SENDER: COMPLETE THIS SECTION**

- Complete items 1, 2, and 3. Also complete item 4 if Restricted Delivery is desired.
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- Attach this card to the back of the mailpiece, or on the front if space permits.

## 1. Article Addressed to:

Mr. Aubrey Derrill Crowe  
President  
Medical Assurance Company Inc  
100 Brookwood Place Suite 500  
Birmingham, AL 35209

## 2. Article Number (Copy from service label)

7000 1670 0006 3511 9787

PS Form 3811, July 1999

Domestic Return Receipt

102595-00-M-0952

**COMPLETE THIS SECTION ON DELIVERY**

A. Received by (Please Print Clearly)

Leslie McQuay

B. Date of Delivery

12-23-0

C. Signature

Leslie McQuay

☐ Agent☐ Addressee

D. Is delivery address different from item 1?

☐ Yes

If YES, enter delivery address below:

☐ No

## 3. Service Type

☒ Certified Mail ☐ Express Mail☐ Registered ☒ Return Receipt for Merchandise☐ Insured Mail ☐ C.O.D.

## 4. Restricted Delivery? (Extra Fee)

☐ Yes



DON SIEGELMAN  
GOVERNOR

STATE OF ALABAMA  
DEPARTMENT OF INSURANCE  
201 MONROE STREET, SUITE 1700  
POST OFFICE BOX 303351  
MONTGOMERY, ALABAMA 36130-3351  
TELEPHONE: (334) 269-3550  
FACSIMILE: (334) 241-4192  
INTERNET: www.aldoi.org

December 18, 2002

D. DAVID PARSONS  
COMMISSIONER  
ASSISTANT COMMISSIONER  
TREY GRANGER  
DEPUTY COMMISSIONER  
JAMES R. (JOHNNY) JOHNSON  
CHIEF EXAMINER  
RICHARD L. FORD  
STATE FIRE MARSHAL  
JOHN S. ROBISON  
GENERAL COUNSEL  
MICHAEL A. BOWNES  
RECEIVER  
DENISE B. AZAR  
LICENSING MANAGER  
JIMMY W. GUNN

Mr. Glen Taylor  
Taylor-Walker & Associates, Inc.  
Actuarial Consulting Group  
P. O. Box 156  
40 North Main  
Midvale, UT 84047

Re: Examination of Medical Assurance Company, Inc.  
As of December 31, 2002

Dear Mr. Taylor:

This letter is to request and authorize your participation in the examination of the above referenced company for the purpose of computing reserves and making other valuations in your usual manner.

The examination will begin on or about January 27, 2003. The examination for this company is being conducted in the company's offices at 100 Brookwood Place, Suite 500, Birmingham, AL 35209, and will cover the period ending December 31, 2002. The expected duration of the examination is approximately six months.

The Examiner-in-Charge will be Ms. Mary Packard. Please contact her at the company after the beginning date to coordinate the scheduling of your portion of this examination. The company telephone number is (205) 877-4400.

If your schedule does not permit you to accept this assignment, please let me know so that other arrangements can be made.

Thank you for your assistance in this matter.

Sincerely,

Richard L. Ford, CFE  
Acting Deputy Commissioner and  
Chief Examiner

RLF:dk

cc: Jack M. Brown, CFE, CIE  
Mary Packard, CFE, Examiner-in-Charge  
Glenda Daniel, Analyst

**SENDER: COMPLETE THIS SECTION**

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- Attach this card to the back of the mailpiece, or on the front if space permits.

1. Article Addressed to:

Mr. Glen Taylor  
Taylor-Walker & Associates Inc.  
Actuarial Consulting Group  
P O Box 156  
40 North Main  
Midvale UT 84047

**COMPLETE THIS SECTION ON DELIVERY**

A. Received by (Please Print Clearly) B. Date of Delivery

C. Signature

X



- ☐ Agent  
☐ Addressee

D. Is delivery address different from item 1?

If YES, enter delivery address below:

- ☐ Yes  
☐ No

3. Service Type

- ☒ Certified Mail ☐ Express Mail  
☐ Registered ☒ Return Receipt for Merchandise  
☐ Insured Mail ☐ C.O.D.

4. Restricted Delivery? (Extra Fee)

- ☐ Yes

2. Article Number (Copy from service label)

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PS Form 3811, July 1999

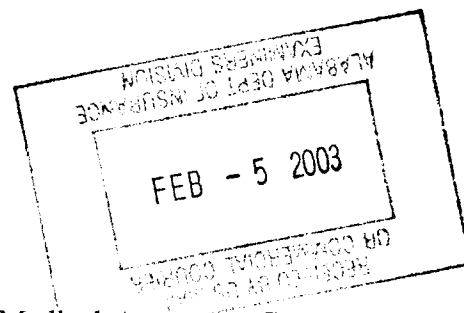
Domestic Return Receipt

102595-00-M-0952



January 28, 2003

Mary B. Packard  
Alabama Insurance Department  
P.O. Box 303351  
Montgomery, AL 36130-3351



Dear Madam:

In connection with the regulatory examination of the The Medical Assurance Company, Inc. ("Company") by the Alabama Insurance Department, the Department has requested that we allow it access to our working papers prepared in connection with our audit of the 2001, 2000, 1999 and 1998 statutory-basis financial statements of the Company.


In connection with the issuance of our auditors' report on the Company's 2001, 2000, 1999 and 1998 statutory-basis financial statements, we issued a qualifications letter dated February 22, 2002, February 14, 2001, February 11, 2000 and February 8, 1999, respectively, to the Company, which the Company filed with the Department. Our audit was conducted with the objectives, and subject to the limitations, stated in that letter. That letter indicates, among other things, that we would make our working papers available to the Department. We have not audited any financial statements of the Company since December 31, 2001, nor have we performed any audit procedures since February 22, 2002, the date of our auditors' report, and significant events or circumstances may have occurred since that date. In addition, any notations, comments, and individual conclusions appearing on any of the audit working papers do not stand alone, and should not be read as an opinion on any individual amounts, accounts, balances or transactions.

Our working papers constitute and reflect work performed or information obtained by Ernst & Young LLP in its capacity as independent auditors for the Company. The documents contain trade secrets and confidential commercial and financial information of our firm and the Company that is privileged and confidential, and we expressly reserve all rights with respect to disclosures to third parties who are not directly involved in the examination of the statutory-basis financial statements as of December 31, 2001, 2000, 1999 and 1998, and for the years then ended. Accordingly, we request confidential treatment under the Freedom of Information Act or similar laws and regulations, to the extent that laws or regulations do not preclude such treatment, when requests are made for the working papers or information contained in them or any documents created by the Department or those acting on its behalf containing information derived from them. We further request that written notice be given to our firm before distribution of the information in the working papers (or photocopies of them) to others, including other governmental agencies, except when such distribution is required by law or regulation.

Any photocopies of our working papers we agree to provide you will be identified as  
"Confidential Treatment Requested by Ernst & Young LLP 1901 6<sup>th</sup> Avenue North, Suite  
1900, Birmingham, AL 35203, (205) 251-2000."

Very truly yours,

Ernst & Young LLP

A handwritten signature in black ink, appearing to read "Douglas W. Johnson". The signature is fluid and cursive, with the first name "Douglas" being more prominent.

Douglas W. Johnson

Partner

MEMORANDUM

TO: Richard Ford, Chief Examiner

FROM: Mary B. Packard, CPA, CFE

SUBJECT COMPANY: Red Mountain Casualty Insurance Company, Inc.

Per your instructions, examination of the above captioned company has been completed. The following information is submitted herewith.

Date Started: February 3, 2003

Date Completed: August 22, 2003

As of December 31, 1996

<u>Examiners Participating</u>	<u>State</u>	<u>Working Days</u>
<u>Mary B. Packard, CPA, CFE</u>	<u>Alabama</u>	<u>39.0000</u>
<u>Jeffrey A. Hawkins</u>	<u>Alabama</u>	<u>7.8750</u>
<u>Jayne Simms</u>	<u>Alabama</u>	<u>3.1250</u>
<u>Lori Wright</u>	<u>Alabama</u>	<u>24.0000</u>
		<u>74.0000</u>

Actuary R. Glenn Taylor, ACAS, MAAA

Should S.I.S. Form be filed? (If 100 or more stockholders)?

NO

Should Proxy Material be filed?

NO

Have all Form B Holding Company filings been completed?

YES

Officers

President: Victor Thomas Adamo

Controller (or person having control of Company books): James Joseph Morello

Claims Managers: Robert David Francis

Proper Mailing Address: 100 Brookwood Place  
Birmingham, AL 35209

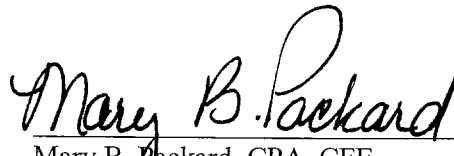
Telephone Number: 205-877-4400

Condition of the Company at 12/31/02

Assets: \$ 17,951,539

Liabilities: \$ 2,122,134

Surplus: \$ 15,829,405

  
Mary B. Packard, CPA, CFE  
Examiner-in-charge

Date: August 22, 2003



BOB RILEY  
GOVERNOR

STATE OF ALABAMA  
DEPARTMENT OF INSURANCE  
201 MONROE STREET, SUITE 1700  
POST OFFICE BOX 303351  
MONTGOMERY, ALABAMA 36130-3351

TELEPHONE: (334) 269-3550

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JAMES R. (JOHNNY) JOHNSON  
D DAVID PARSONS  
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RICHARD L. FORD  
STATE FIRE MARSHAL  
JOHN S. ROBISON  
GENERAL COUNSEL  
MICHAEL A. BOWNES  
RECEIVER  
DENISE B. AZAR  
LICENSING MANAGER  
JIMMY W. GUNN

February 6, 2003

Douglas W. Johnson  
Ernst & Young LLP  
AmSouth/Harbert Plaza  
Suite 1900  
1901 Sixth Avenue North  
Birmingham, AL 35203

Re: Request for CPA Workpapers in December 31, 2002 Examination of The Medical Assurance Company, Inc.

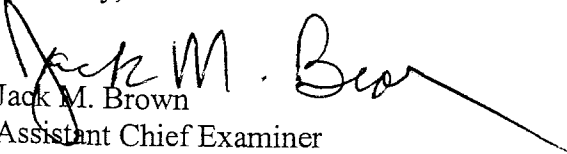
Dear Sir:

We received your January 28, 2003, letter regarding the request for inspection of the workpapers prepared in the referenced examination.

The request to inspect the workpapers is made by your client pursuant to Section 13 of Regulation 100. The letter of qualification your firm provided your insurer client should consent and agree to make available for review by the Commissioner, his designee or his appointed agent, the workpapers prepared in your examination. This agreement and consent is required by Section 12 of Regulation 100. Any copies of your firm's workpapers included in the Department's files will remain confidential to the extent provided under Alabama law.

If you have any questions, please advise.

Sincerely,

  
Jack M. Brown  
Assistant Chief Examiner

cc: Richard Ford  
Mary Packard, Examiner-in-Charge

August 7, 2003

Mary B. Packard, CFE  
Examiner-In-Charge  
Alabama Department of Insurance  
P.O. Box 303351  
Montgomery, AL 36130-3351

We are providing this letter in connection with your examination of the statutory financial statements of The Medical Assurance Company, Inc. as of December 31, 2002. We are responsible for the preparation of the statutory financial statements of financial position, results of operations, and changes in statutory financial position in conformity with the accounting practices prescribed or permitted by the Alabama Department of Insurance.

Certain representations in this letter are described as being limited to those matters that are material. Solely for the purpose of preparing this letter, the term "material", when used in this letter, means any item or group of similar items involving potential amounts of more than \$4,000,000. These amounts are not intended to represent the materiality threshold for financial reporting and disclosure purposes. Notwithstanding this, an item is considered material, regardless of size, if it involves an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it possible that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, the following representations made to you during the examination.

We have made available to you all:

- Statutory financial records and related data; and
- Minutes of meetings of stockholders, directors and committees, or summaries of actions of recent meetings for which minutes have not yet been prepared.

There have been no:

- Fraud or other irregularities involving management or employees who have significant roles in the internal control structure;
- Fraud or other irregularities involving other employees that have or may have a material effect on the statutory financial statements;
- Fraud or other irregularities involving agents, MGA's, third party administrators, independent contractors, holding companies or other individuals or parties that have or may have a material impact on the statutory financial position of the Company; or

- Communication from regulatory agencies concerning noncompliance with, or deficiencies in, statutory financial reporting practices.

We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.

The financial statements are free of material and intentional immaterial misstatements.

The following have been properly recorded or disclosed in the statutory financial statements:

- Any related party transactions and related amounts receivable or payable, including sales, purchases, loans, transfers, leasing arrangements, and guarantees, except as discussed in the Report of Examination.
- All liabilities, both actual and contingent, except as discussed in the Report of Examination.
- Guarantees whether written or oral, under which the Company is contingently liable.
- Capital stock repurchase options or agreements on capital stock reserved for options, warrants, conversions, or requirements.
- Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances and line-of-credit or similar arrangements.
- Significant estimates and material concentrations known to management that are required to be disclosed in accordance with SSAP No. 1, *Disclosure of Accounting Policies, Risk and Uncertainties, or Other Disclosures*.
- Amount of credit risk and extent, nature, and terms of financial instruments with off-balance-sheet risk in accordance with SSAP No. 27.
- Agreements to repurchase assets previously sold.

We confirm the completeness of the information provided regarding the identification of related parties.

There are no violations or possible violations of laws or regulations whose effects should be considered for disclosure in the statutory financial statements or as a basis for recording a loss contingency.

Contingent Liabilities:

- There are no other liabilities or gain or loss contingencies that are required to be accrued or disclosed by SSAP No. 5.
- There is no litigation against the Company that is considered material in relation to the statutory financial position of the Company. For purposes of this section, the Company has excluded litigation for which the only amounts sought relate to benefits within the normal terms of coverage under contracts of insurance issued by the Company, and which are otherwise considered in the actuarial determination of the Company's unpaid claim reserves.

Adequate provision has been made for adjustments and losses in collection of receivables.

Provision has been made for estimated retroactive adjustments by third-party payors under reimbursement agreements.

The Company is in compliance with bond indentures or other debt instruments.

Pending changes in the organizational structure, financing arrangements, or other matters that could have a material effect on the financial statements of the Company are properly disclosed.

The Company has properly classified all assets as admitted or nonadmitted in accordance with SSAP No. 4.

The Company has free and clear title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged except as disclosed in the annual statement.

We have reviewed long-lived assets and certain identifiable intangibles whenever changes in circumstances have indicated that the carrying amount of these assets might not be recoverable and have recorded the adjustment in accordance with SSAP No. 5.

Deferred tax assets and liabilities as reported in the financial statements comply and have been valued in accordance with SSAP No. 10, *Income Taxes*.

The Company has properly disclosed and recorded any premium deficiency reserves in accordance with SSAP No. 53.

Investments are appropriately recorded and valued as follows:

- Bonds – are recorded and disclosed in accordance with SSAP No. 26 and interpretation thereof, except as discussed in the Examination Report.
- Preferred stocks – are recorded and disclosed in accordance with SSAP No. 32 and interpretations thereof.
- Common stocks – are recorded and disclosed in accordance with SSAP No. 30 and interpretations thereof. Common stock of subsidiaries and affiliated or controlled companies are recorded and disclosed in accordance with SSAP No. 46 and interpretations thereof, except as discussed in the Examination Report.
- Short-term investments – are recorded and disclosed in accordance with SSAP No. 2 and interpretations thereof, except as discussed in the Examination Report.
- Real estate – are recorded and disclosed in accordance with SSAP No. 40 and interpretations thereof.

The Company's liabilities for unpaid losses and loss adjustment expenses are based on and recorded at management's best estimate in accordance with SSAP No. 55.

Agents' balances or uncollected premiums have been recorded and disclosed in accordance with SSAP 6, except as discussed in the Report of Examination.

There were no material commitments for construction or acquisition of property, plant and equipment, or to acquire other noncurrent assets, such as investments or intangibles.

We have complied with all aspects of contractual agreements that would have a material effect on the statutory financial statement in the event of noncompliance.

There are no material transactions that have not been properly recorded in the accounting records underlying the statutory financial statements.

All required returns and statutory reporting requirements have been filed on a timely basis with the appropriate regulatory bodies.

All material reinsurance transactions have been recorded and disclosed in accordance with SSAP No. 62.

The Company has properly disclosed and recorded all changes in accounting principles in accordance with SSAP No. 3.

The Company has recorded and disclosed subsequent events in accordance with SSAP No. 9.

The Company is aware of the employment of or a business relationship with a "prohibited person" as defined in The Violent Crime Control and Law Enforcement Act of 1994: United States Code, Section 1033 (e)(1)(A). However, the Company had obtained a temporary waiver for the employee and is seeking a permanent waiver at the time this letter was signed.

We agree with the findings of specialists in evaluating the Loss and LAE Reserves and have adequately considered the qualifications of the specialists in determining the amounts and disclosures used in the financial statements and underlying accounting records. We did not give or cause any instructions to be given to the specialists with respect to the values or amounts derived in an attempt to bias their work.

The Company has recorded and disclosed benefit plans and defined contribution plans in accordance with SSAP No. 8.

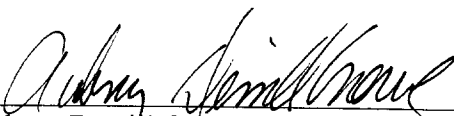
The Company has recorded and disclosed postretirement benefits other than pensions in accordance with SSAP No. 14.

We understand that your examination was made in accordance with standards established by the Alabama Department of Insurance, and procedures established by *the National Association of Insurance Commissioners*, and accordingly included such tests of the

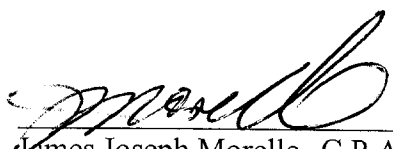


accounting records and such other procedures as considered necessary under the circumstances.

The Medical Assurance Company, Inc.

  
\_\_\_\_\_  
Aubrey Derrill Crowe, M.D.  
Chief Executive Officer

8/7/03  
Date

  
\_\_\_\_\_  
James Joseph Morello, C.P.A.  
Chief Financial Officer

8/7/03  
Date



BOB RILEY  
GOVERNOR

STATE OF ALABAMA  
DEPARTMENT OF INSURANCE  
201 MONROE STREET, SUITE 1700  
POST OFFICE BOX 303351  
MONTGOMERY, ALABAMA 36130-3351  
TELEPHONE: (334) 269-3550  
FACSIMILE: (334) 241-4192  
INTERNET: [www.aldoi.org](http://www.aldoi.org)

WALTER A. BELL  
COMMISSIONER  
DEPUTY COMMISSIONER  
D. DAVID PARSONS  
JAMES R. (JOHNNY) JOHNSON  
CHIEF EXAMINER  
RICHARD L. FORD  
STATE FIRE MARSHAL  
JOHN S. ROBISON  
GENERAL COUNSEL  
MICHAEL A. BOWNES  
RECEIVER  
DENISE B. AZAR  
PRODUCER LICENSING MANAGER  
JIMMY W. GUNN

August 26, 2003

**CERTIFIED MAIL**  
**RETURN RECEIPT REQUESTED**

Mr. Aubrey Derrill Crowe  
President  
Medical Assurance Company, Inc.  
100 Brookwood Place, Suite 500  
Birmingham, AL 35209

**RE: The Medical Assurance Company, Inc.**  
**Report of Examination as of December 31, 2002**

Dear Mr. Crowe:

Enclosed is a copy of the Report of Examination of the above-cited company as of December 31, 2002. In the event that you have any objections to this report, please advise this Department in writing within twenty (20) days, and a hearing will be scheduled, at which time you may present your arguments regarding any objections.

Unless we hear from you within the above-stated time, the report will be filed as a public document. Once filed, no annual or quarterly statements, or other material reflecting the statutory financial condition of the company may be filed with or accepted by this Department if those statements conflict with any basis of calculation to establish the value of any asset, liability, or capital account in the report.

Sincerely,

Richard L. Ford, CFE, CIE  
Chief Examiner

RLF:dk

Enclosure

cc: Jack M. Brown, CFE, CIE  
Mary Packard, CFE  
Glenda Daniel

**SENDER: COMPLETE THIS SECTION**

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- Print your name and address on the reverse so that we can return the card to you.
- Attach this card to the back of the mailpiece, or on the front if space permits.

1. Article Addressed to:

**Mr. Aubrey Derrill Crowe**  
**President**  
**Medical Assurance Company Inc.**  
**100 Brookwood Place Suite 500**  
**Birmingham, AL 35209**

2. Article Number (Copy from service label)

7002 2030 0000 9484 0676

PS Form 3811, July 1999

Domestic Return Receipt

**COMPLETE THIS SECTION ON DELIVERY**

A. Received by (Please Print Clearly) B. Date of Delivery

X Kevin Massey

C. Signature

X Kevin Massey

☐ Agent  
☐ AddresseeD. Is delivery address different from item 1? ☐ Yes  
If YES, enter delivery address below: ☐ No

3. Service Type

☒ Certified Mail ☐ Express Mail  
☐ Registered ☒ Return Receipt for Merchandise  
☐ Insured Mail ☐ C.O.D.

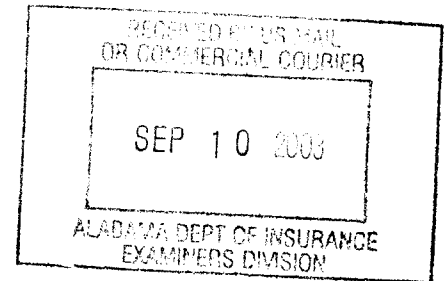
4. Restricted Delivery? (Extra Fee)

☐ Yes

102595-00-M-0952

September 9, 2003

Mr. Richard Ford, Chief Examiner  
State of Alabama  
Department of Insurance  
201 Monroe Street, Suite 1700  
P O Box 303351  
Montgomery, Alabama 36130-3351



RE: The Medical Assurance Company, Inc.  
Report of Examination as of December 31, 2002


Dear Mr. Ford:

Thank you for your letter of August 26, 2003 containing the above mentioned report.

Please be advised that The Medical Assurance Company, Inc. will not be requesting a hearing in conjunction with the Report of Examination as of December 31, 2002.

Thank you for the Department's efforts in conjunction with this report.

Sincerely,

  
A. Derrill Crowe, M.D.  
President

ADC/kn

cc: Jack M. Brown, CFE, CIE  
Mary Packard, CFE  
Glenda Daniel



BOB RILEY  
GOVERNOR

STATE OF ALABAMA  
DEPARTMENT OF INSURANCE  
201 MONROE STREET, SUITE 1700  
POST OFFICE BOX 303351  
MONTGOMERY, ALABAMA 36130-3351  
TELEPHONE: (334) 269-3550  
FACSIMILE: (334) 241-4192  
INTERNET: [www.aldoi.org](http://www.aldoi.org)

WALTER A. BELL  
COMMISSIONER  
DEPUTY COMMISSIONER  
D. DAVID PARSONS  
JAMES R. (JOHNNY) JOHNSON  
CHIEF EXAMINER  
RICHARD L. FORD  
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GENERAL COUNSEL  
MICHAEL A. BOWNES  
RECEIVER  
DENISE B. AZAR  
PRODUCER LICENSING MANAGER  
JIMMY W. GUNN

BEFORE THE INSURANCE COMMISSIONER  
OF THE  
STATE OF ALABAMA

IN THE MATTER OF: )  
FINANCIAL CONDITION EXAMINATION OF )  
THE MEDICAL ASSURANCE COMPANY INC )  
AS OF DECEMBER 31, 2002 )

ORDER

ON THE 25th day of September, 2003, the above entitled cause came on for consideration by the Insurance Commissioner, pursuant to Regulation 103. The Insurance Commissioner, having fully considered and reviewed the Examination Report together with any written submissions or written rebuttals and any relevant portions of the examiners' workpapers, finds and states as follows, to-wit:

JURISDICTION

1. That the Insurance Commissioner has jurisdiction of this cause, pursuant to the provisions of the Alabama Insurance Code.
2. That The Medical Assurance Company, Inc. is a domestic insurer licensed for property, miscellaneous casualty, including official surety bonds, and disability in the State of Alabama.

**ORDER**  
**FINANCIAL CONDITION EXAMINATION**  
**PAGE 2**

**FINDINGS OF FACT**

1. That on August 22, 2003, the verified Financial Condition Examination Report of The Medical Assurance Company, Inc. was filed with the Insurance Department.

2. That following receipt of the December 31, 2002 Examination Report, the Company was afforded a reasonable opportunity of not more than twenty (20) days to make a written submission or written rebuttal with respect to any matters contained in the Examination Report.

3. That Regulation 103 provides that within twenty (20) days of the end of the period allowed for the receipt of written submissions or written rebuttals, the Insurance Commissioner shall fully consider and review the report, together with any written submissions or written rebuttals and any relevant portions of the examiners' workpapers and enter an order. The order shall either: (i) adopt the examination report as filed or with modifications or corrections, including an order that the company take actions to cure any violations; (ii) reject the examination report with directions to the examiners to reopen the examination for purposes of obtaining additional data, documentation or information; or (iii) call for an investigatory hearing for purposes of obtaining additional documentation, data, information and testimony.

4. Regulation 103 requires the company to file affidavits executed by each of its directors stating under oath that they have received a copy of the adopted report and related orders within thirty (30) days of the issuance of the adopted report.

**CONCLUSIONS OF LAW**

1. That the December 31, 2002 Financial Condition Examination Report of The Medical Assurance Company, Inc. shall be and hereby is Adopted by the Insurance Commissioner, pursuant to Regulation 103.

**ORDER**  
**FINANCIAL CONDITION EXAMINATION**  
**PAGE 3**

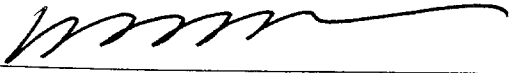
**ORDER**

IT IS THEREFORE ORDERED by the Commissioner of Insurance as follows:

1. That the December 31, 2002 Financial Condition Examination Report of The Medical Assurance Company, Inc. is hereby Adopted.
2. That The Medical Assurance Company, Inc. file an affidavit with the Alabama Department of Insurance stating that a copy of the adopted report and related orders were reviewed by the board of directors within thirty (30) days of the issuance of the adopted report.
3. That The Medical Assurance Company, Inc. file an affidavit with the Department of Insurance within thirty (30) days of the issuance of the adopted report that the company filed a copy of the adopted report and related orders with all licensing states and the NAIC. An affidavit form is attached.
4. That The Medical Assurance Company, Inc. shall comply with the recommendations set forth in the Report of Examination, and that failure by The Medical Assurance Company, Inc. to so comply may result in sanctions or administrative action; and further, that The Medical Assurance Company, Inc. shall file with the Department of Insurance within thirty (30) days of the order a statement signed by an appropriate official of the company stating the corrective action taken to comply with the recommendations made in the Report of Examination.

WITNESS My Hand and Official Seal this 25th day of September, 2003.

(SEAL)

  
\_\_\_\_\_  
Walter A. Bell  
Insurance Commissioner  
201 Monroe Street, Suite 1700  
Montgomery, Alabama 36130  
(334) 269-3550

CERTIFICATION

I, \_\_\_\_\_, \_\_\_\_\_ (office) of \_\_\_\_\_ Company, do hereby certify that the Report of Examination of \_\_\_\_\_ Company as of \_\_\_\_\_, \_\_\_\_\_, was filed with all states in which \_\_\_\_\_ Company is licensed, and with the office of the National Association of Insurance Commissioners.

By: \_\_\_\_\_

Sworn and subscribed before the undersigned authority on the \_\_\_\_ day of \_\_\_\_\_, 2003.

Seal

\_\_\_\_\_  
Notary



**SENDER: COMPLETE THIS SECTION**

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- Print your name and address on the reverse so that we can return the card to you.
- Attach this card to the back of the mailpiece, or on the front if space permits.

## 1. Article Addressed to:

Aubrey Derrill Crowe  
President  
The Medical Assurance Company Inc.  
100 Brookwood Place, Suite 500  
Birmingham, AL 35209

## 2. Article Number (Conv from service label)

7002 2030 0000 9484 0775

PS Form 3811, July 1999

Domestic Return Receipt

102595-00-M-0952

**COMPLETE THIS SECTION ON DELIVERY**

A. Received by (Please Print Clearly) B. Date of Delivery

C. Signature

X

Frank Massey

☐ Agent

☐ Addressee

D. Is delivery address different from item 1? ☐ Yes  
If YES, enter delivery address below: ☐ No

## 3. Service Type

☒ Certified Mail

☐ Express Mail

☐ Registered

☒ Return Receipt for Merchandise

☐ Insured Mail

☐ C.O.D.

## 4. Restricted Delivery? (Extra Fee)

☐ Yes

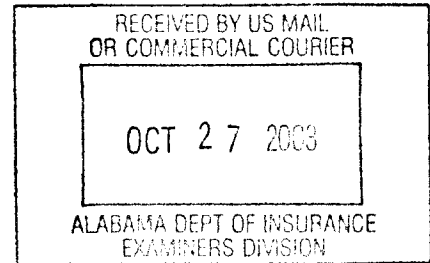


5) J. Holtz

2) Fewer years

October 24, 2003

Mr. Walter A. Bell  
Insurance Commissioner  
201 Monroe Street, Suite 1700  
Montgomery, Alabama 36130



RE: Report of Examination on The Medical Assurance Company, Inc. for the five years ended December 31, 2002

Dear Commissioner Bell:

In connection with the above referenced report, we are submitting our responses to the recommendations contain therein. As used in this letter; Department refers to the Alabama Department of Insurance, and Company refers to The Medical Assurance Company, Inc.

**Conflicts of Interest – Page7**

**The Department recommends** that directors, officers and other employees sign the Conflicts of Interest Statement every year in accordance with the Statement of Policy on Conflicts of Interest.

**Response:** It is a practice of TMAC to have all officers and directors of the Company sign a Conflicts of Interest Statement each year. One of the instances cited in the report referenced a director who was at the end of a terminal illness and did not attend the Board meeting at which the statements were signed. The other example cited related to the fact that Medical Assurance had recently merged with ProAssurance and the company was being restructured. There were no new officers appointed that had not previously signed a Conflicts of Interest Statement the prior year. These officers were under an existing obligation to inform the Company if any new conflicts arose since the last signing of the Statements. The Company believes these to be isolated incidents and will ensure that directors, officers and other employees sign the Conflicts of Interest Statement in accordance with its Statement of Policy on Conflicts of Interest. All current officers and directors have signed a Conflicts of Interest Statement.

### **Employee and Agent Welfare – Page 13**

**The Department recommends** that the Company determine if any prohibited persons, as defined in the Violent Crime Control & Law Enforcement Act of 1994, U.S. Code, Section 1033, are employed or may be employed by the Company.

**Response:** The Company will determine if any prohibited persons, as defined in the Violent Crime Control & Law Enforcement Act of 1994, U.S. Code, Section 1033, are employed or may be employed by the Company.

### **Claims Review – Page 16**

**The Department recommends** that the Company maintain guidelines for the reservation of rights letter and notice of excess loss.

**Response:** The Company will maintain guidelines for the use of the reservation of rights letter and notice of excess loss letter.

**The Department recommends** that the Company's claim files maintain the reserve change form to support the reserve adjustment.

**Response:** The Company has instituted a companywide requirement that the Company's claim files maintain a reserve change form to support any reserve adjustment.

### **Policyholder Complaints – Page 17**

**The Department recommends** that the Company's complaint register consist of all written grievances, from both complaints made directly to the Company and complaints filed with the appropriate Department of Insurance, in order to be in accordance with the NAIC Market Conduct Examiner's Handbook.

**Response:** The Company has commenced recording all written grievances, including complaints made directly to the Company and complaints filed with the appropriate Department of Insurance in order to be in compliance with the NAIC Market Conduct Examiner's Handbook. The Company will continue this process indefinitely.

### Agents' Licensing Requirements – Page 17

**The Department recommends** that the Company be able to provide the Notice of Cancellation for all producers that are terminated.

**Response:** The Company will keep records of all Notice of Cancellations for all producers that are terminated.

### Reinsurance – Page 17

**The Department recommends** that the Company maintain appropriate levels of managerial experience when entering into transactions relating to, but not limited to, reinsurance assumed transactions with the foreign and/or alien insurance market.

**Response:** The Company will maintain appropriate levels of managerial experience when entering into transactions related to, but not limited to, reinsurance assumed transactions with the foreign and/or alien insurance market. If necessary, outside experts will be retained.

**The Department recommends** that the Company periodically audit the ceding companies to determine whether the accounting data is being provided in accordance with the contract provisions.

**Response:** In the future, the Company will periodically audit the ceding companies to determine whether the accounting data being provided is in accordance with the contract provisions.

**The Department recommends** that the Company maintain complete copies of its reinsurance agreements in its office and make such agreements readily available for review.

**Response:** The Company will maintain complete copies of its reinsurance agreements in its office and make such agreements readily available for review.

### Accounts and Records – Page 19

**The Department recommends** that the Disaster Recovery Plan be tested completely and to have the written results on file.

**Response:** The Company is in the process of finalizing its comprehensive Disaster Recovery Plan and intends to test it completely as soon as practicable. Written documentation of the testing results will be kept on file.

**The Department recommends** that the Company prepare and implement a records retention program in accordance with IRS Revenue Procedure 1998.

**Response:** The Company will establish an Electronic Records Retention Policy in accordance with the minimum retention requirements of Alabama Department of Insurance Regulation Number 118 and with the IRS Revenue Procedure 1998.

**The Department recommends** that the Company prepare written procedural manuals for all departments.

**Response:** In conjunction with the recent Sarbanes-Oxley requirements, the Company is in the process of formalizing internal controls and implementing testing procedures. The Company will prepare written procedural manuals for all departments.

**The Department recommends** that the Company maintain documentation of the management's responses to the recommendations of the internal audit reports.

**Response:** The Company will maintain documentation of management's responses to the recommendations of the internal audit reports.

#### **Bonds – Page 25**

**The Department recommends:**

- that the Company value securities in accordance with the standards of the NAIC Securities Valuation Office as required by Alabama Department of Insurance Regulation Number 98 and the NAIC Annual Statement Instructions.
- that the Company submit all securities with a "Z" designation to the Securities Valuation Office for valuation within 120 days of the date the security is acquired as required by the Purposes and Procedures Manual of the NAIC Securities Valuation Office.
- that the Company use the proper CUSIP number when preparing Schedule D as set forth in the NAIC Annual Statement Instructions.
- that the Company include the proper "PE" designations when reporting provisionally exempt securities on Schedule D - Part 1 as required by the Purposes and Procedures Manual of the NAIC Securities Valuation Office.
- that the Company obtain fair values from independent sources as required by the NAIC when completing Schedule DM.

**Response to all:** The Company employed an internal investment manager in late 2002. Additionally, it outsourced its detail accounting function for investments effective January 1, 2003. The Company believes that the implementation of these

actions will provide the additional controls necessary to eliminate these deficiencies and other related deficiencies as noted within other sections of this report.

#### **Common stocks – Page 26**

##### **The Department recommends:**

- that the Company report SCA Investments to the NAIC Securities Valuation Office by filing a SUB 1-form filing within thirty days of acquisition and filing a SUB 2-form by June in each of the following years.
- that the Company refer to the Treasury Stock and Reciprocal Ownership Elimination Worksheet of the NAIC Securities Valuation Office when valuing stock in its ultimate parent, ProAssurance Corporation.

**Response to all:** No SUB-1 forms were required during the period. The appropriate SUB-2 forms were filed on June 24, 2003. The Company has implemented procedures to insure the filing of the forms by June 1<sup>st</sup> of each year.

#### **Cash and short-term investments – Page 26**

**The Department recommends** that the Company comply with ALA. CODE §27-37-3 (1975), ALA. CODE §27-37-4(b)(2) (1975) and SSAP No. 4 when evaluating the characteristics of an asset and determining if it should be admitted.

**Response:** The Company is actively pursuing reducing the assets held in trust to equal the recorded reserves. Also, the Company will in the future non-admit amounts held in these trusts that are more than the recorded reserves.

**The Department recommends** that the Company include a complete and accurate description of securities on Schedule DA - Part 1 as required by the Purposes and Procedures Manual of the NAIC Securities Valuation Office.

**Response:** The Company believes this will be resolved through the actions take as outlined under “Bonds”.

**The Department recommends** that the Company enter a CUSIP number that conforms to those as provided and published by the Securities Valuation Office in accordance with the NAIC Annual Statement Instructions when preparing Schedule DA - Part 1.

**Response:** The Company believes this will be resolved through the actions take as outlined under “Bonds”.

**The Department recommends** that the Company receive as collateral transferred securities having a fair value at least equal to 102 percent of the purchase price paid as required by SSAP No. 45.

**Response:** The Company has implemented procedures to provide that collateral of 102% of the purchase price is given.

**Premiums and agents' balances in course of collection – Page 27**

**The Department recommends** that the Company comply with the NAIC Annual Statement Instructions, by including “Receivable amounts due” when calculating Premiums and agents' balances in course of collection.

**Response:** The Company will include all “Receivable amounts due” when calculating Premiums and agent's balances in course of collection.

**The Department recommends** that the Company comply with the NAIC Annual Statement Instructions, which state “Corrections of errors in previously issued financial statements...should be reported on the Aggregate write-ins for gains and losses in surplus line.”

**Response:** The Company will report “Corrections of errors in previously issued financial statements” on the Aggregate Write-ins for Gains and Losses in the surplus line.

**The Department recommends** that the Company calculate the agents' balances or uncollected premiums on a policy basis rather than using an estimate to determine what should be reported under Premiums and agent's balances in course of collection.

**Response:** The Company will calculate these balances on a per policy basis.

**Premiums, agents' balances and installments booked but deferred and not yet due – Page 28**

**The Department recommends** that the Company comply with the NAIC Annual Statement Instructions, by including “Receivable amounts not yet due” when calculating Premiums, agents' balances and installments booked but deferred and not yet due.

**Response:** The Company will include “Receivable amounts not yet due” when calculating Premiums, agent's balances and installments booked but deferred and not yet due.

**The Department recommends** that the Company calculate the agents' balances or uncollected premiums on a policy basis rather than using an estimate to determine what should be reported under Premiums, agent's balances and installments booked but deferred and not yet due.

**Response:** The Company will calculate these balances on a per policy basis.

#### **Reinsurance recoverable – Page 28**

**The Department recommends** that the Company comply with the NAIC Annual Statement Instructions, which state to include "Amounts recoverable on losses and loss adjustment expenses that will be recovered from the ceding companies."

**Response:** The Company will comply with this request.

**The Department recommends** that the Company comply with the NAIC Annual Statement Instructions, which require that Notes to the Financial Statements, under Number 22, Section D, Uncollectible Reinsurance describe uncollectible reinsurance written off during the year. SSAP No. 62, paragraph 67 also requires disclosure of uncollectible reinsurance.

**Response:** The Company will disclose amounts considered uncollectible during the year.

#### **Receivable from parent, subsidiaries and affiliates – Page 29**

**The Department recommends** that the Company not establish receivables with affiliates which are not supported by an agreement.

**Response:** The Company will comply with this recommendation.

**The Department recommends** that the Company comply with the NAIC Annual Statement Instructions, which state to include only unsecured current accounts receivable from parent, subsidiaries and affiliates.

**Response:** The Company has corrected these reports.

**The Department recommends** that the Company not net payables and receivables from unrelated entities in accordance with the NAIC Annual Statement Instructions and SSAP No. 64.

**Response:** The Company will comply to report payables and receivables separately.



**Commissions payable, contingent commissions and other similar charges – Page 30**

**The Department recommends** that the Company pay the commission rates listed in the commission agreements or amend its commission agreements to reflect the correct commission rates.

**Response:** The incident referred to involved a one-time deviation from the contracted commission rate in states where the Company had ceased to offer occurrence coverage and converted its existing policies to claims-made coverage. Since initial claims-made premiums are lower than occurrence premiums, an adjustment in agent commission rate was made to adequately compensate the agent and maintain a consistent dollar commission level. The Company will pay the commission rates listed in the commission agreements or amend its commission agreements to reflect the correct commission rates.

**Other expenses – Page 31**

**The Department recommends** that the Company include Unclaimed Property in Amounts withheld or retained by company for account of others as required by the NAIC Annual Statement Instructions.

**Response:** This item is the result of an error in internal reports used to compile statutory reporting. The Company has corrected these reports.

**Amounts withheld or retained by company for account of others – Page 31**

**The Department recommends** that the Company comply with ALA. CODE §35-12-27 (1975), which requires the Company to deposit with the State Treasurer funds that are unclaimed for over five years.

**Response:** The Company will comply with this recommendation.

**The Department recommends** that the Company include Unclaimed Property in Amounts withheld or retained by company for account of others as required by the NAIC Annual Statement Instructions.

**Response:** This item is the result of an error in internal reports used to compile statutory reporting. The Company has corrected these reports.

### **Provision for reinsurance – Page 31**

**The Department recommends** that the Company comply with the Alabama Department of Insurance Regulation Number 105 and ALA. CODE §27-5-12(iv)4 (1975), which requires that the trustee of a trust agreement be a qualified U.S. financial institution.

**Response:** The Company will implement a procedure to insure that each trust is with a qualified U. S. financial institution.

**The Department recommends** that the Company comply with the NAIC Annual Statement Instructions and report trust funds and other acceptable securities under column 10, Other Allowed Offset Items.

**Response:** The Company will report trust funds and other acceptable securities under column 10, Other Allowed Offset Items.

**The Department recommends** that the Company comply with the NAIC Annual Statement Instructions and include all unauthorized reinsurers on Schedule F - Part 5.

**Response:** The Company will include all unauthorized reinsurers on Schedule F – Part 5.

**The Department recommends** that the Company comply with the NAIC Annual Statement Instructions when completing Schedule F - Part 6. Reinsurance recoverables in dispute should be excluded from Columns 4 and 5 and included in Column 9.

**Response:** The Company will exclude recoverable amounts in dispute from columns 4 and 5 and include disputed recoverable amounts in column 9.

**The Department recommends** that the Company write off uncollectible reinsurance recoverables in accordance with SSAP No. 62, paragraph 56 and write off the uncollectible reinsurance balance through the accounts, exhibits and schedules in which they were originally recorded.

**Response:** The Company has implemented procedures to identify and disclose uncollectible amounts related to reinsurance.

### **Payable to parent, subsidiaries and affiliates – Page 33**

**The Department recommends** that the Company not have business transactions with affiliates that are not supported by an agreement.

**Response:** The Company will not have business transactions with affiliates that are not supported by an agreement, where required by law.

**The Department recommends** that the Company report payables and receivables from different entities separately in accordance with the NAIC Annual Statement Instructions and SSAP No. 64.

**Response:** The Company will comply to report payables and receivables separately.

**Premium deficiency reserve – Page 33**

**The Department recommends** that the Company implement a formal procedure to evaluate the possible requirement of a premium deficiency reserve.

**Response:** A formal process has been implemented.

**Common capital stock – Page 34**

**The Department recommends:**

- that the Company correct the transfer error of \$125,808 between paid in and contributed surplus, and common capital stocks.
- that the Company reconcile the stock outstanding to the general ledger.

**Response to all:** After the correction of the transfer error in July 2003, the Company's outstanding stock reconciled with the Company's ledger.

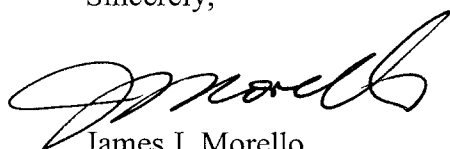
**Subsequent Events – Page 35**

**The Department recommends** that the Company comply with ALA. CODE §27-41-5 (1975) submit regular reports of investments to the Board of Directors.

**Response:** The Director of Investments prepares reports for the Investment Committee quarterly. In turn, the minutes of the Investment Committee are presented to the Boards of the Company and ProAssurance Corporation for their approval on a regular basis.

We appreciate the Department's efforts in conjunction with this exam and we are available to address any questions and provide additional information if needed.

Sincerely,

A handwritten signature in black ink, appearing to read 'J. Morello', with a stylized, cursive script.

James J. Morello  
Treasurer

CERTIFICATION

I, A. Derrill Crowe, Chairman (office) of  
The Medical Assurance Co, Inc Company, do hereby certify that the Report of Examination of  
The Medical Assurance Company, Inc Company as of October 24, 2003 was filed with all states in  
which The Medical Assurance Company is licensed, and with the office of the National Association of  
Insurance Commissioners. Inc.

By A. Derrill Crowe

Sworn and subscribed before the undersigned authority on the 24<sup>th</sup> day of October, 2003.

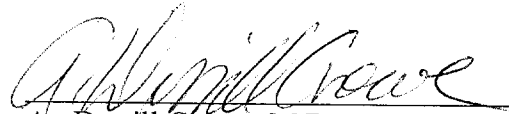
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Kathryn A. Nevill  
Notary

My Commission Expires 3-13-06

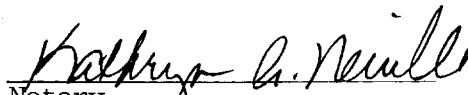
AFFIDAVIT

I, A. Derrill Crowe, director of The Medical Assurance Company, Inc., do hereby certify that I have received and reviewed the Report of Examination of The Medical Assurance Company, Inc. as of December 31, 2002 as adopted and all related orders.

  
A. Derrill Crowe, M.D.

Dated: October 23, 2003

Sworn and subscribed before the undersigned authority on the 24th day of October, 2003.

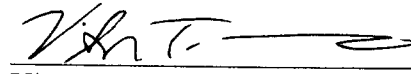
  
Notary

Seal

My Commission Expires 3-13-06

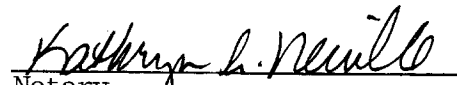
A F F I D A V I T

I, Victor T. Adamo, director of The Medical Assurance Company, Inc., do hereby certify that I have received and reviewed the Report of Examination of The Medical Assurance Company, Inc. as of December 31, 2002 as adopted and all related orders.

  
\_\_\_\_\_  
Victor T. Adamo

Dated: October 23, 2003

Sworn and subscribed before the undersigned authority on the 24th day of October, 2003.

  
\_\_\_\_\_  
Notary

Seal

My Commission Expires 3-13-06

A F F I D A V I T

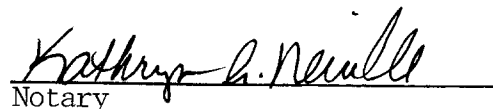
I, Howard H. Friedman director of The Medical Assurance Company, Inc., do hereby certify that I have received and reviewed the Report of Examination of The Medical Assurance Company, Inc. as of December 31, 2002 as adopted and all related orders.



Howard H. Friedman

Dated: October 23, 2003

Sworn and subscribed before the undersigned authority on the 24th day of October, 2003.



Notary

Seal.

My Commission Expires 3-13-06





Medical  
Assurance®

A ProAssurance Company

Medical Assurance, Inc.

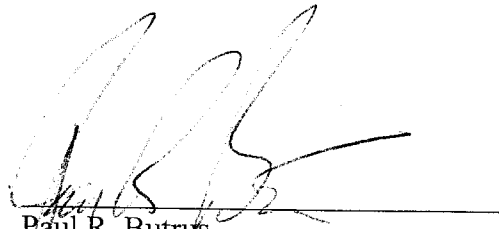
800/282-6242

Fax 205/802-4799

www.MedicalAssurance.com

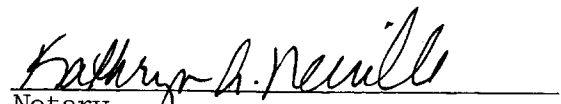
AFFIDAVIT

I, Paul R Butrus, director of The Medical Assurance Company, Inc., do hereby certify that I have received and reviewed the Report of Examination of The Medical Assurance Company, Inc. as of December 31, 2002 as adopted and all related orders.

  
Paul R. Butrus

Dated: October 23, 2003

Sworn and subscribed before the undersigned authority on the 24th day of October, 2003.

  
Notary

Seal

My Commission Expires 3-13-06